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SEPARATION OF STATE AND LOCAL REVENUES IN THE UNITED STATES

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SEPARATION OF STATE AND LOCAL REVENUES IN THE UNITED STATES

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PREFACE

The problem of the separation of state and local revenues is one which has received much attention recently from students of finance and state officials, and while it has not yet been widely adopted it is almost invariably discussed when financial reforms are under consideration. In this monograph, the writer has endeavored to make a comparative study of separation in those states where this aspect of the relation of state and local revenues is most prominent—attempting to ascertain the causes of its growth, its relation to increases in revenue and expenditures, and its effect on the distribution of the tax burden.

The writer wishes to take this opportunity to acknowledge her indebtedness to Professor Stephen I. Miller of Leland Stanford Junior University for suggesting the subject of the monograph, and to Professor Edwin R. A. Seligman, under whose direction the study has been made. Thanks are also due to Professor Robert M. Haig for much helpful criticism, to Professor Carl C. Plehn of the University of California and Mr. A. C. Pleydell of the New York Tax Reform Association for reading portions of the manuscript and for making many valuable suggestions, and to those state officials who have courteously supplied the writer with information not available in their published reports.

MABEL NEWCOMER.

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CHAPTER I

Introduction

I. FAILURE OF THE GENERAL PROPERTY TAX

In the United States at the present time there exists a growing dissatisfaction with the state and local revenue systems. Such dissatisfaction is not new nor is it peculiar to this country, but a number of causes have contributed in making the problem unusually serious here in recent years.

Revenue systems are rarely kept abreast of needs. By the time a need has become sufficiently acute to be felt, analyzed, and met with proper legislation, conditions have often so changed that such legislation is inadequate, if not positively injurious. Hence the satisfaction lags behind the manifestation of the need, and discontent arises in approximate proportion to the lag. If, as seems to be the case, the need is not met as quickly in the United States as in other progressive countries, the fact may be attributed in part to more rapid development, and in part to less effective governmental machinery,—although greater unwillingness to submit to unsatisfactory conditions may be held accountable for much complaint. And if, as is undoubtedly the case, dissatisfaction has increased in the past few decades, this may be attributed on the one hand to the rapid growth of expenditures resulting from increasing governmental activities, and on the other to the development of such varied forms of wealth and such complex industrial conditions that the locally administered general property tax, which is so widely employed in

this country, is no longer adequate to meet the situation.[1] As long as land was plentiful and other forms of wealth comparatively scarce—as long, that is, as agriculture completely overshadowed manufacturing in importance—the general property tax was not grossly unjust or very oppressive. But with the increase of intangible property and the extension of business beyond local and beyond state boundaries an increasing amount of taxable property evades its share of the tax, and our rapidly increasing expenditures must be met by a tax on a narrowing base.

The general property tax, employed by practically all countries during some phase of their development, has been abandoned as the main source of revenue by all well developed countries, with the exception of Switzerland, Australia and the United States; and it is no longer adaptable to the conditions existing in these countries.[2] Arising as a simple way of producing the necessary revenues in small agricultural communities, it has been allowed to remain, although never very satisfactory, and long since outgrown. Under present conditions it not only fails to reach much intangible property but it permits of gross inequalities in the assessment of tangible property. Further, the right of the locality to derive taxes from corporate property within its jurisdiction is often questionable.

It is in order to abolish unequal local assessments (or at least to avoid the evil consequences of such inequalities), to reach corporate property, which comprises a large share of intangible property, and to do away with the unequal distribution among local divisions of the proceeds from the tax on public utilities, that separation has been proposed.

[1] *Cf.* Edwin R. A. Seligman, *Essays in Taxation* (Revised Ed., 1913), p. 347 *et seq.*

[2] *Ibid.*, p. 140. Switzerland may constitute in the minds of some an exception to this statement.

This last reason Professor Plehn holds to be the controlling one. Equal assessment, he believes, may be obtained in other ways, and also satisfactory taxation of corporations, but only through separation can the satisfactory distribution of taxes from public utilities be realized.[1] However, it is generally considered to be primarily an administrative reform, designed so to improve the machinery of the revenue system that taxes may be levied and collected with an approach to justice and efficiency. "The separation of state and local revenues is not a cure," says Professor Seligman, "but it will help to make a cure possible." [2]

2. MEANING OF "SEPARATION OF STATE AND LOCAL REVENUES"

The term "separation of state and local revenues" is applied to various methods of taxation. When first proposed as a definite fiscal measure it was used to denote a system in which state and local revenues are derived from wholly independent sources. This practically means that there shall be no state tax levied on general property, the state revenue being obtained from taxes on special classes of property which are exempted from local taxation. This method, separation of the *sources* of state and local revenues, is the one ordinarily designated by the term, and the one most widely adopted in the United States, although in no case has such separation of sources been strictly observed.

As defects in this system have been revealed, various modifications and substitutions have suggested themselves. These have been advanced under the name of separation as possible improvements over the first system. One important

[1] *Proceedings of the Ninth National Conference on State and Local Taxation*, 1915, p. 51. Hereafter these Proceedings will be referred to as *Conference.*

[2] Seligman, *op. cit.*, p. 351.

modification, first suggested (1899) by Mr. Allen Ripley Foote [1] in order to obviate the inelasticity of revenues and the danger of extravagant state expenditure, is the introduction of apportionment by expenditure,—viz., that the state revenue required in addition to the yield of special taxes shall be derived from a direct tax on property, apportioned among the local divisions according to local revenue or expenditure instead of according to assessed valuations. This is as effective as separation of source in equalizing assessments, and if used only as a supplementary tax does not seriously interfere with the other benefits of separation.

More recently Professor Plehn has advanced another method which he designates as "pure separation," as distinguished from "segregation." [2] The latter term he applies to separation of source, i. e. to systems where property is classified for taxation and divided between the state and the localities,—it being a matter of indifference whether the various classes of property are taxed in the same way or in different ways. "Pure separation" occurs where different taxes are used by the state and the localities, although these taxes may be derived from the same source. The California method of reserving corporate property for the state and assigning the property of natural persons to the local divisions is segregation; whereas a system employing the general property tax for local purposes and an income tax for state purposes would be pure separation. Separation of source, with certain modifications, is the method which has been most widely advocated and most generally applied in the United States, and consequently it is the method most frequently discussed and most vigorously opposed. This is the form of separation which will be considered in this monograph.

[1] Seligman, *op. cit.*, p. 359 n.

[2] *Conference*, 1915, p. 58.

3. THEORY OF SEPARATION

In examining either the efficiency or the equity of a revenue system two relations must be considered: first, the relation of the individual to the state; and second, the relation of the central to the local governments. In other words there are two fundamental problems to be solved,—the problem of the distribution of the burden of revenues among the inhabitants of a state on the one hand, and on the other the problem of the division of administration and of yield among the various jurisdictions.

One solution has been offered for both of these problems.[1] It is to charge in proportion to benefit for those services the individual benefit of which is measurable and to make the administration of such services and the administration and use of the revenues derived from them local functions. Services, on the other hand, the benefit from which is general and cannot be assigned to particular persons or properties, are to be made state functions, and the revenues necessary to perform such services are to be derived from taxes imposed according to ability or faculty.

The advocates of this system do not go so far as to say that all functions should be divided between the localities and the state according as the individual benefit is or is not ascertainable. They would not radically change present systems. Rather they assume that the present division of state and local functions corresponds roughly to such a scheme. They are merely attempting to analyze present conditions. Unfortunately in practice the dividing line between matters of general and matters of local concern is very vague. The fact is that the variations in different countries and com-

[1] See discussions in C. F. Bastable's *Public Finance* (3d ed., London, 1903), pp. 119 *et seq.*, 393 *et seq.*; Seligman, *op. cit.*, p. 478; G. Schanz, "Zur Frage des Steuer Prinzips bei den Gemeinde-Steuern," *Finanz-Archiv*, 32 Jhrg., erster bd., pp. 54-55.

munities at the same time, and at different periods of time, are so great that it is scarcely safe to call any function distinctly local or central. The division suggested does not exist, and even if it could be satisfactorily made the localities would still be confronted with the difficulty of assigning the overhead expenses of the general government, the special benefit of which is not determinable.

The final objection to such a scheme is that, both in theory and in practice, the criterion of ability, in so far as ability can be measured, is being accepted and applied in many cases where the individual benefit is determinable. The use of special assessments is growing rapidly, and such assessments are determined by benefit; moreover, benefit is the primary consideration in charging incorporation fees or gas rates, and it is still customary to cover at least the cost of service in supplying water or transportation facilities. But in these latter instances, at least, it is an open question whether the gain in well-being which might be obtained by charging only a nominal sum would not make it advisable to operate such utilities at a loss. And in the matter of education, where special benefit is largely measurable, the criterion of benefit has long since been abandoned. In truth the standard of ability promises to supplant that of benefit in a large number of cases where the individual benefit is obvious; so that even if it might be conceded that local affairs were always those conferring special benefit it would not always follow that the localities might defray the cost of their activities from fees collected in carrying them on. This standard—that state revenues should be in accordance with ability, and local revenues in proportion to benefit—was advanced, and to some extent applied, in Prussia as the standard for assigning revenues to the state and local governments when revenues were separated by the reforms of 1895.[1] No attempt has been

[1] Seligman, *op. cit.*, p. 478; Schanz, *op. cit.*, pp. 54-55.

made, however, to apply this standard where separation has been introduced in the United States. Other principles have been observed, both in assigning the sources to each division of government and in justifying such assignment.

Ability, as measured by progressive rather than proportional taxes, is now the generally accepted principle for dividing the burden among individuals. Although progressive taxes are at best a crude measure, they are more nearly exact than proportional taxes; they at least approach our present conception of justice; and they have the additional advantage of producing large revenues. Consequently they are widely favored.

But no such well-recognized guiding principle has been offered to solve the other problem,—that of administration and division of revenues; and it is with the solution of this problem that separation in the United States is concerned. In practice, administration and use of revenues have usually gone together, especially in the United States, though even here there are some notable exceptions. But this would not seem to be necessary. The choice of the administrative agent may be determined primarily by administrative efficiency,—i. e., the collections of the various revenues may be put into the hands of that authority best able to collect them, whether or not they are to be used by that authority.[1] Administrative efficiency is not always dependent on use, nor can it of itself be accepted as justification for use. Use, or division of yield, must be determined by some less tangible principle of right or need. Consequently this problem, which is the fundamental problem of separation, resolves itself into two distinct parts. These must be solved separately, for the most satisfactory results cannot be obtained by always combining administration and use as under separation of sources.[2]

[1] Bastable, *op. cit.*, p. 393 *et seq.*

[2] *Ibid.*, p. 404 *et seq.*

If it be conceded that the authority administering revenues need not be the same as the authority using them, efficiency would seem to be the most reasonable standard for determining the best administrative agent. And efficiency is in fact the criterion which is being widely accepted,—so widely indeed that separation of sources has been largely determined on this basis,[1] while the problem of deciding which authority can best use the proceeds has been made a secondary consideration. As a result of this and of hesitation to separate administration and use there is a tendency to assign to the state the proceeds of those sources which it has been found can be better administered by the state. Then in order to provide the localities with revenues they have been assigned the general property tax, as the least objectionable tax for local administration. Whether local administration of this tax is more efficient than state administration is questionable;[2] but as long as administration and use are combined it would seem to be the only feasible division.

This is the foundation on which separation has been based. But it has been further fortified by a justification—quite unrelated to efficiency—of the use of revenues by those jurisdictions to which they have been assigned from motives of expediency. This justification is simply that values should be taxed only by that government whose people have created them,—that, to give a specific instance, a few power plants supplying electricity to an entire state should be taxed by that state, and not by the counties where the most of their

[1] As shown by the later detailed discussion it has been the failure to enforce the general property tax which has led to the introduction of state-administered special taxes and to the consequent growth of separation. *Cf.* also *Report of the Commission on Revenue and Taxation* (Sacramento, 1906), p. 81 *et seq.*

[2] *Conference*, 1907, p. 523.

property happens to exist, and whose people contribute little or nothing to the value of the plants.

In spite of the fact that the presence of corporate property in a municipality often occasions considerable local expenditure, this theory of allocation of revenues has been generally accepted by the advocates of separation; [1] not only does it seem reasonable that those who create values have the best right to share in them, but such a division also corresponds, at least roughly, to needs, since increases in values and in governmental expenditures follow the growth of population. This division has not been, and cannot be, applied with great precision. Much of the wealth taxed by the state is created by local conditions; much is of national or international origin. But although the value of certain corporations may be of distinctly local origin while that of certain real estate, especially in commercial centers, may be of state, national or even international derivation, still the assignment of corporate property to the state, and of other property to the localities, probably accords in the main with the division advocated; and whether or not such a division is realized it does improve the effectiveness of administration, and satisfies in large measure the needs and claims of the different jurisdictions. This is the justification of separation as it has been realized, and the basis on which further separation is advocated.

4. ARGUMENTS FOR AND AGAINST SEPARATION

Accepting these as the underlying principles upon which separation has been built, attention can now be given to the specific advantages and disadvantages advanced in support of, or in opposition to, the measure. When it was first ad-

[1] Seligman, *op. cit.*, pp. 352-353; C. C. Plehn, "Tax Reform in California," *Conference*, 1911, pp. 116-117; H. C. Adams, *Science of Finance* (New York, 1899), pp. 501-502.

vocated as a definite financial reform, one of the chief advantages attributed to it was that it would lead to home rule, or local option, in taxation.[1] In fact it was called a home-rule measure. It was supposed that, since the removal of the state tax would do away with the necessity of uniform systems, the local divisions would then be given some freedom to adapt their systems better to their varying needs. The liberty specifically desired was the liberty to exempt personalty, and in some cases improvements on real estate. However, this is no longer so widely advanced as an argument in favor of separation. Whatever the advantages of home rule, and its value is at least debatable, it is a distinct issue.[2] Separation opens the way,—but home rule need not follow, and has not followed. Nowhere has it been adopted, nor does the demand for it seem to be growing.[3]

A second argument advanced by the advocates of separation combines the principles that taxes should be administered by that agency which can administer them most efficiently, and that the yield of taxes should be assigned to

[1] *Commission on Revenue and Taxation*, 1906, p. 11; *Conference*, 1907, p. 495.

[2] Seligman, *op. cit.*, pp. 367-368.

[3] An increasing number of local-option amendments are brought up for consideration annually in various western states, but their regular defeat does not suggest that they are growing in popularity. Attempts to obtain local option in California since separation has been introduced have been uniformly unsuccessful. (*Cf. infra*, p. 173). Limited local option exists with separation in Vermont. Here localities have permission to exempt the property of mining and manufacturing corporations for ten years. (*Cf. infra*, p. 109). Rhode Island, without separation, gives the localities the privilege of exempting certain property. (*Report of the Board of Tax Commissioners*, Rhode Island, 1913, p. 41.) In Colorado, also without separation, Pueblo exempted improvements on real estate from local taxation by a charter amendment under the general home-rule powers granted to Colorado cities, but the amendment was repealed in 1915. (Y. Scheftel, *Taxation of Land Value* [Boston, 1916], pp. 456-457). This is the extent of local option in the United States.

that authority, the patronage of whose people occasions the value taxed. This argument is that separation is in accord with the natural division of governmental activities and follows the principle already laid down in the separation of national and state revenues. Some tax subjects, such as real estate, are purely local in character and are more easily assessed by local officials, while other subjects, such as insurance companies, do a state business, and can be more easily reached by the state. Great injustice often arises from leaving corporate property to local taxation, for it frequently occurs that valuable property lies in comparatively undeveloped regions, which do not contribute appreciably to its support, and do not need the large revenues it yields.[1]

The remaining arguments are all in support of the assertion that separation brings improved administration. In the first place it is maintained that it removes the diversity of interests, and consequent conflicts, between city and county, which interfere with the enacting of good laws. The counties are constantly complaining that they are paying an undue share of the state tax, since a greater proportion of their property than of city property is in tangible form.[2]

The argument most often brought forward is that separation will tend to equalize assessments, or at least to eliminate the disadvantages of inequalities. Low and unequal assessments are prevalent throughout the United States. It is not unusual for assessed valuation of real estate to vary from 20 to 80 per cent in a single state and when personalty is included even greater variations occur.[3] While many

[1] *Cf.* arguments advanced in Seligman, *op. cit.*, p. 352 *et seq.*, and in *Conference*, 1915, p. 51.

[2] Seligman, *op. cit.*, p. 356.

[3] *Reports of Minnesota Tax Commission*, 1908-1912, *passim; Report of the Illinois Tax Commission on the Tax System*, 1910, p. 21 *et seq.*

causes, among them political considerations and ignorance on the part of assessors, are responsible for these inequalities, it is held that one of the principal factors is the state tax on general property apportioned according to assessed valuation. So long as the taxpayers of a county where property is assessed at fifty per cent of real value have to pay in state taxes only half as much, relatively, as the taxpayers of a county where property is assessed at full value, there will always be a tendency among the counties to compete in undervaluing their property. The removal of the state tax will eliminate this incentive to undervaluation, and the local assessors, it is claimed, will then raise their ratio to approximately full value,—particularly as a high assessment will permit of a low tax rate, a consideration in local advertising. And even if this should not occur, with no state tax the principal objection to inequalities is removed. This abolishes the need of state equalization, which has never been very successful.[1]

It is further claimed by proponents of the measure that the redistribution of the tax will equalize the burden as between different kinds of property.[2] A partial shifting of the tax from real estate to intangible property will result—the state corporation tax reaching intangibles more successfully [3]—and greater equality will thus be attained, since real estate is paying more under the general property tax than other property.

Objections to all of these arguments are advanced by

[1] Seligman, *op. cit.*, p. 22. Professor T. S. Adams, however, believes that equalization has not yet been given a fair trial, and that under intelligent and centralized control it would prove entirely successful. (*Cf.* discussions in *Conference*, 1907, p. 527, and *Annals of the American Academy of Political and Social Science*, vol. lviii, pp. 138-139).

[2] *Commission on Revenue and Taxation*, 1906, pp. 79-80.

[3] State corporation taxation is an essential feature of all schemes of separation thus far adopted.

opponents of separation.[1] Considering home rule first, they agree that it is encouraged by separation, but they consider it to be undesirable. However, home rule, as indicated above,[2] is a distinct problem, and whatever its advantages or disadvantages it need not be considered here.

Concerning the conformity of this system to the natural divisions of governmental activities the opponents object, with reason, that there is no necessary relation between the two; that control should be determined by convenience and efficiency of administration, taxation by fiscal needs, and owing to the united political and social organization of the state and local divisions these needs can be better satisfied by a unified revenue system.[3]

With regard, further, to the relation of revenues to needs under separation, it is claimed by opponents that it takes away from the cities their great source of revenue; consequently the burden probably falls most heavily on them, and they are already overburdened with municipal taxes, for city expenditures are rising more rapidly than any other. Quoting Professor T. S. Adams:

> What separation actually does is to substitute for a conscious distribution of state burdens in accordance with the value of property, an unconscious, unseen, and more or less haphazard distribution, which shifts the burden we know not where, avoids the evils of faulty equalization according to property by flying to other ills we know not of.[4]

Professor Adams further says

[1] See discussions by Professor T. S. Adams (*Conference*, 1907, p. 515 *et seq.*), by Professor C. J. Bullock (*Quarterly Journal of Economics*, vol. xxiv, p. 437 *et seq.*,) and Professor J. E. Brindley, ("Problem of Tax Reform in Iowa," *Conference*, 1910, p. 155).

[2] *Cf. supra*, p. 18.

[3] *Conference*, 1910, p. 156.

[4] *Conference*, 1907, p. 523.

Unless the presence of property at a place has no connection with public expenditure of that place, unless the right to exploit the commercial opportunities of a place creates no obligation to pay taxes at that place, . . . then street car companies, heating and lighting plants, most banks, and some telephone companies owe most of their fiscal allegiance to fairly well defined local districts, and when these local districts are deprived by the state of the power of taxing such corporations they are saddled with burdens of state taxation which belong elsewhere.[1]

Diversity of interest, it is maintained, will not be removed. The burden must fall somewhere, and it will result in opposing the interests of city and rural, of manufacturing and residence districts.[2]

Concerning the equalization of assessments the opponents argue that the desire to avoid state taxes is a minor cause of undervaluation, the state tax being always a small proportion of the total.[3] To obtain fair valuations requires expert treatment which only the central government can give.

[1] *Conference*, 1907, p. 525.

[2] *Quarterly Journal of Economics*, vol. xxiv, p. 449.

[3] Though the state tax amounted only to 11.6 per cent of the total property tax in the United States in 1902 it is not on that account a negligible factor. As Professor Seligman points out (*op. cit.*, pp. 355-356) the proportion of state to county expenditure is larger than the proportion of county to town expenditure. The ratio for the general property tax, with which alone assessments are concerned, was, 1913, 49.1 per cent (state to county) as compared with 42.6 per cent (county to town). In the less developed states this ratio is reversed, (46 per cent as compared with 283 per cent in Arizona, 1913), and even in California before separation the proportion of county to town revenues from general property greatly exceeded the proportion of state to county. However, in the more developed states, comprising most of those considering separation, the proportion of state to county taxes is by far larger, even where separation exists in a measurable degree. (Computed from data in Census Report, *Wealth, Debt and Taxation*, 1913, vol. ii.)

Unequal assessments are due rather to the inherent difficulties of the task, political pressure, personal considerations, insufficient time and pay given to the assessors, and the desire to evade the county tax. The need of equalization remains.

In addition to these objections it is argued that separation leads to wastefulness. Lack of a direct tax prevents the people from feeling the burden.[1] Counties and municipalities will urge state expenditure because the burden falls on corporations, and corporations will urge county and municipal expenditure to retaliate, and because of benefits accruing.[2] The result is extravagance. People in general lose interest, and corporations are forced into politics.

Finally the opponents of separation contend that it will give no elastic state tax, and will lead either to insufficient state revenue or insufficient local revenues.[3] The proponents of the measure, however, argue that state revenue may be supplemented, if necessary, by a tax apportioned according to local expenditure, although the possibilities of special taxes are by no means exhausted, the desired elasticity may be obtained by making variable one tax, e. g. the inheritance tax, by the accumulation of a surplus, or by the use of apportionment by expenditure; and local revenue may be increased by the division of the state surplus.[4]

Separation, as has been said,[5] is not in itself a reform, but opens the way to reform. It makes possible more efficient administration, and reaches sources which escape under the general property tax. The end sought is improved administration and increased revenues through the abolition of the

[1] *Quarterly Journal of Economics*, vol. xxiv, p. 454.

[2] *Report of the State Tax Commission of Arizona*, 1912, p. 25.

[3] *Quarterly Journal of Economics*, vol. xxiv, p. 453.

[4] Seligman, *op. cit.*, p. 358 *et seq.*

[5] *Supra*, p. 11.

state general property tax and the substitution of more just and effective special taxes. All alike agree that improved administration is desirable, but the opponents of separation believe that this is not the way to obtain it. They offer instead apportionment by expenditure,[1] or centralized administration without reference to separation.[2]

5. SEPARATION IN FOREIGN COUNTRIES

Although separation has arisen in the United States only in dealing with the problem of the general property tax it has been introduced into other countries for other reasons. France and Belgium, to be sure, cling to a unified system in which local taxes are derived from the same sources as central taxes,[3] and subventions are largely resorted to,—the whole system being highly centralized.[4] In England, however, although administration is closely controlled by the central authorities, the national and local governments have no taxes in common except the probate duty which is administered by the central government and returned in part to the localities. The national government levies taxes on incomes, on some forms of personalty, and, since 1910, on land. The localities are supported by local rates on real estate (quite distinct from the national land taxes), certain licenses and subventions. Although the national and local authorities share none of their taxes (with the one exception named), this system involves very little separation of source.[5] In Switzerland, where the general property tax is still widely used, the local tax systems are

[1] *Conference*, 1911, p. 253 *et seq.* [2] *Conference*, 1907, p. 526.

[3] The changes made in the land tax in France, 1914, have not interfered with its use as both a central and local tax. The new income tax (1914), however, is, as yet, used only for central purposes. (*Journal des Economistes*, 6 ser., tome 49, 1916, p. 277 *et seq.*)

[4] Grice, J. W., *National and Local Finance* (1910), ch. vii-xiv.

[5] *Ibid.*, chs. ii-vi; see also Seligman, *op. cit.*, p. 482 *et seq.*

for the most part combined with those of the cantons, the local taxes being in the form of additions to the canton taxes. In the French cantons the tendency is toward highly centralized administration like that of France, but in the German cantons a considerable degree of local autonomy in administration is granted. There is, however, no appreciable degree of separation.[1]

In Prussia, and to a considerable extent throughout Germany, fairly complete separation exists. The fiscal system of Prussia was revolutionized by several laws passed in 1893 and put into effect in 1895. The principle underlying the reform was that, owing to the difference in the relations of the citizens to the state and to the town, state taxes should be levied according to ability, and local taxes according to benefit. Consequently it was provided that the state income tax, already in use, should be supplemented by a property tax, and the land, building and business taxes should be abolished as state taxes. Local revenue was to be derived mainly from fees and special assessments, and direct taxes on real estate and business. Limited use of indirect taxes and of a local income tax was also permitted. While these laws have developed a number of defects[2] they seem, as a

[1] F. Ott, *Die Vermögens- und Einkommens-Steuer in der Schweiz* (Zurich, 1914), *passim*.

[2] This system (which exists in a number of states) is severely criticized by Dr. Schanz. Separation has resulted in higher taxes on real estate than on other wealth—in some cases the ratio is five to three—which, he argues, is indefensible, since the owners of real estate are no more benefited by local expenditure than the owners of other wealth. He believes that local taxes, like state taxes, should be in accordance with ability, since state and local functions are much the same, and in so far as the different jurisdictions perform the same sort of services they should obtain their revenues in the same way. (*Finanz-Archiv*, 32 Jhrg., p. 54 *et seq.*) This criticism does not apply to separation in the United States. No general attempt has been made to levy local taxes in accordance with benefit and one of the chief aims of separation has been to reduce the burden on real estate.

whole, to have proved satisfactory, and the resulting separation of the state and local revenues is generally considered to be a great advance over the former system.[1]

Canada has developed a satisfactory system of taxation wherein complete separation of provincial and local revenues exists in all of the nine provinces. By the British North American Act of 1867 the federal government retained all of the customs duties and excises, and the provinces were restricted to licenses and direct taxes. The former were small and the latter were entirely in the hands of the municipalities. Consequently, in order that the provinces might not be embarrassed by insufficient revenues the act provided further that the federal government should assume the provincial debt, and grant to the provinces specific subsidies, and in addition the revenue from the crown lands or an indemnity in place of it. The revenues collected by the provinces themselves arise, for the most part, from corporation taxes, licenses and fees. The municipalities obtain their revenue mainly from direct taxes on property and business.[2]

6. SEPARATION IN THE UNITED STATES

During the colonial period and in the early history of our states, the general property tax, outside of New England, was not widely used, except as a local tax. Many of the colonists were unaccustomed to such a tax, and the slight need of revenues and the existence of other large sources which later disappeared made its use unnecessary. Before the Revolution the import duties formed an important source of revenue, and later, when these were taken from the

[1] Seligman, *op. cit.*, p. 437 *et seq.*

[2] S. Vineberg, "Provincial and Local Taxation in Canada," *Columbia University Studies in History, Economics and Public Law*, 1912, vol. lii, pp. 153-156.

states, large revenues were obtained from licenses, lotteries, state investments, and the sale of public lands.[1]

Direct taxes were early used to a limited extent, but these took the form of taxes on specific subjects rather than all property, and assessments were made on arbitrary values instead of on selling values.[2] These taxes were first combined into a general property tax in the New England States during the early nineteenth century. The Middle Western States followed,—making the general property tax the central tax of their fiscal systems as they entered the Union. During the era of internal improvements—the second quarter of the century—the Middle Atlantic States were forced to resort to this tax, and the Southern States followed shortly afterward.[3] In the North and West the tax was readily accepted, but the Southern States endeavored, with some success, to check its growth by developing business license taxes, and the Middle Atlantic States only turned to it when their reckless, and for the most part unsuccessful, policy of state aid to internal improvements forced them to obtain larger revenues. However, the general property tax was so generally accepted, when it was finally introduced, that only in Delaware and Pennsylvania has it never become an important state tax; yet owing to the earlier absence of such a tax in many states, and the large dependence on indirect sources in others, separation, partial or complete, existed in most of the states until nearly 1850.[4]

The separation thus existing was not, however, adopted

[1] R. T. Ely, *Taxation in American States and Cities* (New York, 1888), bk. ii, chs. i-ii; J. H. Hollander, ed., "Studies in Taxation," *Johns Hopkins University Studies*, nos. 1-4, 1900; for systems of states discussed in this monograph, *cf. infra, passim.*

[2] Ely, *op. cit.*, p. 132.

[3] Seligman, *op. cit.*, pp. 16-17.

[4] Ely, *op. cit., passim*; Hollander, *op. cit., passim.*

consciously as a desirable fiscal principle. The property tax, which was a burden to all, was unpopular in many of the states, and for the most part there was no difficulty in obtaining sufficient revenues without it. When greater revenues were needed the direct tax was resorted to for state and local purposes, as the simplest means of supplying the growing needs. The new system abolished separation, and no attempt was made to retain it. It was believed by some [1] that the direct tax would check extravagance, but the continued large expenditures in New York after the introduction of the direct tax, and the reckless investments of Massachusetts, and later Michigan, where the general property tax was well established,[2] do not suggest that the absence of a direct tax was the main cause of extravagance. Separation was abandoned unconsciously, as it had been employed unconsciously, with no intelligent consideration of its desirability or undesirability. It was not even thought of, apparently, as a definite fiscal principle. In the attempt to meet growing expenditures the state tax on property was rapidly developed, and during the third quarter of the nineteenth century it became practically universal.

With the paying off of the state debts incurred during the Civil War taxation again became very burdensome; and the agitation arising in the attempt to lighten this burden brought with it the realization that the general property tax, introduced to meet the earlier need, was inadequate for this new and greater demand. With changing conditions the tax was proving defective. Corporations were rapidly increasing, and with them intangibles, which the general property tax failed in large part to reach. During the last quarter of the nineteenth century the emphasis was shifting

[1] E. g., *Report of the Comptroller*, New York, 1844, p. 76.

[2] *Cf.* reports of financial officials of these states.

from property to the income from property, the growth of corporations being probably largely responsible for this also; for investments in stocks and bonds were increasing, and property consisted more and more of rights to the income from wealth rather than the concrete items of wealth themselves. Further, the government was restricting the rights of private property.[1] This change soon manifested itself in the field of taxation. On the one hand, to tax property, valuable because of the expected future yield of income, though yielding little or nothing at the time of taxation, was obviously a hardship. On the other hand, the failure to reach large incomes arising from intangible wealth (such as is now designated as corporate excess, good will or franchise value) caused gross inequalities, which were felt to be even more flagrant as the principle of progressive taxation, the logical development of the faculty theory, grew. Inequalities of assessment of all forms of property only added to the difficulties.

Persistent but unsuccessful efforts were made to enforce the general property tax as it stood. Almost equally ineffective attempts were made to devise new taxes to reach personalty. Then the plan of classifying property was tried, different methods of taxation being applied to the different classes. Under this system it was found that certain taxes could be satisfactorily administered only under central control, and it naturally followed, in many cases, that the state appropriated for its own use the revenue from such taxes as it administered, and relinquished to the localities as compensation other taxes, which they were more capable of handling. This process, distinguishable nearly half a century ago, is still going on today. In this way the separation of state and local revenues has again arisen un-

[1] Principally through the regulation of corporations.

consciously, and it has been—and still is in many places—growing in this way, an incidental result of other changes. Consequently all states obtain a part of their revenue under the principle of separation.

Along with its incidental growth, however, separation has been advanced as a definite reform,—and this advocacy of separation, as in itself a step forward, has unquestionably been an important factor in the attainment of separation in such states as New York, where the movement was initiated through classification; and in one state, California, separation was adopted as a conscious reform without any preliminary development of special taxes.

CHAPTER II

Separation in Delaware

Complete separation of revenues exists in Delaware, not as the outcome of slow, planless development in the struggle to increase revenues, or as the result of a conscious effort to equalize burdens, but as a survival of the widespread system existing in this country in the early nineteenth century, before the general property tax had grown to its present supremacy.

License taxes and revenues from investments have supplied the state with considerable income,—although decreasing in importance,—and for a time before 1800 the general income tax was used, and later a poll tax.[1] The general property tax was employed only occasionally, and for brief periods,—first from 1798 to 1804, again from 1814 to 1819, then in 1833, and finally from 1869 to 1877.[2] The failure to establish the general property tax is due to the control of the legislature by agricultural interests and to the relatively small need of revenues. While per capita wealth is comparatively small ($1,493 in 1913 as compared to $1,965, the average for the United States) so also is per capita state expenditure ($3.15 in 1913 as compared with $3.95, the average for the United States).[3] Moreover the state has profited by revenues from the corporations which it has encouraged to incorporate there. A large debt has never

[1] Ely, *op. cit.*, p. 122.

[2] *Report of the State Revenue and Taxation Commission* (Delaware, 1909), p. 45.

[3] *Wealth, Debt and Taxation*, 1913, vol. i, p. 26; vol. ii, p. 40.

accumulated and the problem of taxation has never become acute.

The question of revenues has been further simplified by the fact that the constitution permits classification. This has made it possible to introduce special corporation taxes. In 1820 a tax was imposed on the capital stock of banks.[1] This tax was extended to national banks in 1866, and the rate was reduced in 1869. At present certain banks pay one-fourth of one per cent on paid-up capital. Others pay one-fifth of one per cent on capital stock, surplus and undivided profits, and are exempt from all other taxes.[2] A passenger tax was placed on steamboats in 1821, and on stage coaches in 1829.[3] Railroads, however, were not taxed until 1864. The Delaware Railroad, chartered in 1836, had been granted a fifty-year exemption, but in 1864 a passenger tax was placed on all transportation companies. Five years later railroads were subjected, in addition, to a number of special taxes, on net earnings, capital stock, locomotives, passenger cars and freight cars. This complex system was suspended in 1873,—the various taxes being commuted for lump sums determined by the legislature.[4] This, except for changes in the amount of the lump sums due, is the method of taxation used today.

Insurance companies were first taxed in 1869. At present life-insurance companies pay two per cent on general property less return premiums and reinsurance. Other companies pay one and one-half per cent on gross premiums, except domestic fire insurance companies which pay $100 annually. Life insurance companies pay in addition a franchise tax of three-tenths of one per cent on gross

[1] *Revenue and Taxation Commission*, 1909, p. 65 *et seq.*

[2] *Wealth, Debt and Taxation*, vol. i, p. 491.

[3] *Revenue and Taxation Commission*, 1909, p. 21 *et seq.*

[4] *Ibid.*, p. 22.

premiums and three-fourths of one per cent on surplus. Other insurance companies pay a franchise tax of three-fourths of one per cent on gross premiums.[1]

Telegraph and telephone companies pay 20 cents to 60 cents per mile of wire, and telephone companies pay in addition 25 cents per transmitter. Both also pay a franchise tax of one per cent on gross receipts within the state.

Express companies pay six per cent on gross earnings of interstate business plus $250 license fees. They also pay a franchise tax of one per cent on gross earnings. Steam, gas and electric companies pay one mill on gross receipts; also a franchise tax on gross receipts of two-fifths of one per cent, which, in the case of companies with dividends in excess of four per cent, is in addition to a tax of four per cent on such excess dividends. Pipe lines pay a franchise tax of three-fifths of one per cent and parlor car companies pay one of one and one-half per cent on gross earnings.

All mercantile, manufacturing and miscellaneous corporations doing less than fifty per cent of their business in the state are subject to a tax which runs from $5 on capital of $25,000 or under to $25 per $500,000 on capital of $1,000,000 and over. These companies are subject also to various license taxes, some of which were so reduced in 1907, at the instance of the manufacturers paying them, that the state has suffered a serious loss of revenues.

Finally all corporations are subject, upon incorporation, to the charter mill tax of ten cents per $1,000 capital, with a minimum of $10. This is the largest single source of revenue in the state.

Such is the system of corporation taxation in Delaware. Expediency, apparently, has been the sole guide. Almost every conceivable base has been experimented with, and in

[1] For a complete account of the present revenue system see *Wealth, Debt and Taxation*, 1913, vol. i, p. 491.

consequence there are rather serious inequalities. But the taxes have not been heavy and the system has produced revenues ample for the state's needs.

An inheritance tax, first imposed in 1869, yielded in 1915 approximately 1.5 per cent of all revenue.[1] It is a collateral tax of one to five per cent graded according to relationship, on all estates over $500. The return from state investments yields about the same amount. There are no other important sources of state revenue, aside from the corporation taxes already mentioned, and licenses.

There has been a steady, but not large, increase in revenues. Revenues of the general fund increased 61 per cent in the twenty years from 1873 to 1893, and 123 per cent in the twenty years from 1893 to 1913.[2] Revenues are rising more rapidly than this in over half of the states.[3] The revenues of the general fund in 1915 were $810,300. They were distributed as follows:

TABLE I

REVENUES OF THE GENERAL FUND, 1915[4]

Source	*Amount*	*Percentage*
Railroads	$112,000	13.8
Telegraph and telephone	14,400	1.7
Express	2,500	0.3
Franchise tax	96,700	11.9
Incorporation fees	117,400	14.5
Bank and insurance	73,400	9.0
Licenses	156,900	19.3
Inheritance tax	11,100	1.4
Dividends	11,900	1.5
Other	214,000	26.6
Total	810,300	100.0

[1] Computed from data in *Annual Report of the State Treasurer of Delaware*, 1915.

[2] Computed from data in *Auditor's Report* for 1873 and *Treasurer's Report* for 1893 and 1913.

[3] *Wealth, Debt and Taxation*, 1913, vol. ii, pp. 36-39.

[4] Compiled from data in *Report of State Treasurer*, 1915.

The local divisions depend almost entirely on the general property tax. In 1913, 72 per cent of local revenue receipts came from this source.[1] This tax has a wide base since the only property reserved for state taxation is the railway right of way. In consequence it is not especially burdensome and the localities have no difficulty in obtaining ample revenue.

The average tax rate in 1912 was $1.91 per $100 assessed value. This makes the rate on actual value of real estate $1.02, if the rate of assessed to true value in the census report[2] may be accepted. This is not a high rate.

There has been but little centralization of the administration of local taxes.[3] One assessor is elected for each "hundred"[4] and it is his duty to assess the property of corporations as well as of natural persons. The only equalization obtained is through the board of revision of assessment of each district, which is composed of the assessor and two citizens appointed by the levy court. The functions of this board are to supervise and equalize assessments. There is no equalization between counties.[5]

All state revenues are collected by the treasurer, except certain licenses which are collected by the clerks of the peace. A collector appointed by the governor investigates statements of taxable property filed with clerks of the peace.

This system is fairly satisfactory, largely owing to the fact that the demands on it are light. It has never been called upon to meet the test of heavy expenditures. Consequently it is of little significance in the study of separation

[1] Compiled from data in *Wealth, Debt and Taxation*, 1913, vol. ii.

[2] *Ibid.*, vol. i, p. 16.

[3] *Ibid.*, vol. i, pp. 489-493.

[4] The local unit of assessment.

[5] *Wealth, Debt and Taxation*, vol. i, p. 492.

of sources of revenues. It is in the more highly developed states, where the enormous growth of expenditures has made development of revenues an exceedingly difficult and serious problem, that the advantages and limitations of separation can best be judged. And it is in these states, where the greatest strain has been put upon financial systems, that separation has been most often introduced.

CHAPTER III

SEPARATION IN PENNSYLVANIA

I. HISTORY OF TAXATION IN PENNSYLVANIA

PENNSYLVANIA'S experiments with special taxes led her early to fairly successful taxation of intangibles.[1] As a result this state, like Delaware, has never depended long on the general property tax for state revenues, although for a few years it became the principal source of revenue.

A state direct tax was first levied in 1785, but being found to be both unsuccessful and unnecessary it was discontinued in 1789. The receipts from the sale of public lands and the interest on state investments supplied the larger part of state revenues for many years. These sources yielded 26.4 per cent and 36.2 per cent, respectively, of all state revenues in 1810 as compared with 23.6 per cent from taxes—which were mostly license taxes.[2]

Specified classes of personal property were first taxed by the state in 1831, at the rate of one mill. In addition a one-mill state tax was added to all real and personal property taxed locally. These realty and personalty taxes were levied for only five years, it being confidently expected that the income from canals, railroads and other public works, whose cost of construction was the occasion of the levy, would soon be sufficient to support the state.[3] They were

[1] *Infra*, p. 38 *et seq.*

[2] Ely, *op. cit.*, p. 45.

[3] T. K. Worthington, "Historical Sketch of the Finances of Pennsylvania." *American Economic Association Publications*, vol. ii, no. 2, p. 38 (1887).

consequently given up in 1836. Money received from the federal government through the distribution of the surplus in 1837, and through the United States Bank rechartered by the Pennsylvania legislature, sufficed the state until 1840.[1] But the canals and railroads failed to yield the returns anticipated, and the debt became so large that it was found necessary to take definite action in this year. A law was enacted imposing taxes on bank stock, certain classes of personalty and the salaries of state officials. But this was entirely inadequate. In 1839, expenditures had exceeded revenues, exclusive of loans, by over five million dollars ($6,971,000 as compared with $1,900,000), yet the new sources were expected to yield scarcely more than half a million, and actually did yield somewhat less. Loans necessarily continued, but the credit of the state was so poor that it was found necessary first, in 1841, to obtain money through state "bills of credit" which was unconstitutional, and then, in 1842, to pay interest to creditors by means of interest-bearing certificates.[2]

This serious financial condition of the state finally aroused the people so that the legislature was forced to pass more decisive measures for relief. In 1843 the sale of state securities and public works was considered. Two-thirds of the stock was sold in this year and the sale of public works was attempted the year following, but was not actually accomplished until 1858.[3] The most important measure was the enactment in 1844 of a law subjecting to taxation for state and county purposes all real estate not specifically exempt, all personal estate, corporate stock, bank capital and individual incomes. The proceeds of these taxes were devoted to the payment of the interest on the debt. Revenues from

[1] Worthington, *op. cit.*, p. 42. [2] *Ibid.*, p. 55 *et seq.*

[3] B. M. Nead, *Financial History of Pennsylvania*, 1682-1881 (Harrisburg, 1881), p. 23 *et seq.*

taxes and licenses rose, following this law, from $396,000 in 1843 to $1,113,000 in 1844, and to over $2,000,000 in 1846.[1] In 1845 the tax on real and personal estate alone supplied $1,318,332. This was the largest single source of revenue. Canal and railroad tolls, which were the next largest source, yielded $1,154,592.[2] In addition to increasing revenue, the state practiced real economy in expenditure, and the credit of the state was at once restored. The debt was not reduced appreciably the years immediately following, but in 1849 a sinking fund was established, being supplied by the proceeds from the inheritance tax and the taxes on charters and various licenses.

This system supplied ample revenues until the outbreak of the Civil War, when new special taxes were created. For the next twenty years the state continuously enacted and repealed laws in the effort to adjust revenues to needs, but with all the changes there was a rapid growth in corporation taxes and a steady decline in taxes on other property. The state tax on real estate was repealed in 1866 and has never since been imposed. In 1873 and 1874 taxes on horses and cattle, and on corporate loans, were repealed.[3] Many other changes were made in the years following, and in 1885 the personalty tax was completely revised in a notable effort to reach that part (estimated to be 85 per cent of the whole) which was escaping. The state tax was reduced from 4 to 3 mills; mortgages and other evidence of indebtedness were exempted from all local taxation; and provision was made for the better recording of such mortgages to make the state tax more effective.[4]

[1] Worthington, *op. cit.*, p. 63 *et seq.*

[2] *Report of the Auditor General of Pennsylvania*, 1843, p. 5.

[3] F. M. Eastman, *Taxation for State Purposes in Pennsylvania* (1898), pp. xii-xiii.

[4] *Ibid.*, p. 152.

This act completed the separation which had been started with the exemption of realty from the state tax in 1867. There was a sharp division of sources. The localities depended on realty, and certain forms of tangible personalty exempt from state taxation; the state depended on personalty, principally intangible, reserved exclusively for the state and reached through a variety of taxes. In 1889 one-third of the tax on personalty was returned to the local districts in lieu of all claims for collection. This proportion was raised to three-fourths in 1891 and the rate on personalty was raised again to four mills. In 1913 the tax was abolished as a state tax,—such personalty as was subject to it being turned over to the counties to be taxed by them at the same rate.[1] The state still retains its tax on the loans of private and municipal corporations. This is the extent of Pennsylvania's experience with general taxes. Only at intervals between 1831 and 1866 was any real general property tax levied.

The first important special tax was one on bank dividends imposed in 1814. This was made a graduated tax in 1835.[2] In 1840 banks were subjected, in addition to this, to the capital stock tax imposed in that year. Both the scope and the rate of these taxes were slightly increased by later changes, making banks, as compared with other corporations, heavily taxed. In 1866 certain reductions were made, and changes, sometimes unimportant, sometimes vital, but mostly in the form of reductions and exemptions, were made frequently thereafter. The most sweeping changes took place in 1881 when an optional tax on the par value of stock was offered in lieu of all other taxes except real estate; in 1889 when the rate of this tax was raised and the tax was

[1] *Wealth, Debt and Taxation*, 1913, vol. i, p. 642.

[2] Eastman, *op. cit.*, p. 89.

made compulsory; and in 1897 when the system was unified and equalized by abolishing the distinction between stock taxable to the bank and shares taxable to the individual and placing on all banks a 4 mill tax on actual value, with the option of a 10 mill tax on the par value of all shares.[1]

No attempt was made to reach other corporations until 1840, except for the one mill state personal property tax of 1831, which included corporate stocks. But in 1840 a tax was imposed on the dividends of all domestic corporations, and later extended to joint stock companies. This was changed to a capital stock tax in 1844, and this tax, with some changes, still exists. Manufactures were exempted by the laws of 1879 and 1885.[2]

In 1849 premiums and deposits of foreign insurance companies received within the state were specially taxed. Except for a reduction of the rate in 1889, this tax remains today. One-half of the yield is returned to the localities. Domestic insurance companies were not selected for special taxation until 1877, when an 8 mill tax was imposed on gross premiums and assessments received within the state.[3]

All corporations, except transportation companies, not paying the state tax on dividends were subjected in 1864 to a tax on net earnings such as already existed (1861) for private bankers and brokers. This was later extended to unincorporated banks and savings institutions. In 1875 corporations subject to the capital stock tax and gross premiums tax were withdrawn from this act.[4]

A specific tax was imposed on the loans of private corporations in 1864, to be collected from the corporations. Such loans had been under the personal property tax before this. The tax was repealed in 1874, but reënacted in 1879,

[1] Eastman, *op. cit.*, p. 89 *et seq.*

[2] *Ibid.*, p. 60.

[3] *Ibid.*, p. 107.

[4] *Ibid.*, p. 110.

and revised several times thereafter. The present rate of 4 mills has been employed since 1891.[1]

In 1866 transportation companies were taxed on gross receipts within the state. This tax was repealed in 1873 but reënacted in 1877, the rate at this time being made 8 mills.[2]

By the acts of 1868 and 1897 organization taxes were imposed on corporations at the rates of one-fourth and one-third of one per cent of authorized capital stock according to the character of the corporation.[3] In 1901 these were extended to the stock of foreign corporations employed within the state, and the base of the tax was made actual instead of authorized capital stock.

In 1897 building and loan associations were brought under a tax similar to that on banks. This same year an annual excise tax was placed on express companies. The rates were average gross receipts per mile.[4]

To sum up, at the present time a capital stock tax of 5 mills is imposed on all corporations, domestic and foreign, except banks, trust and foreign insurance companies, and manufacturing companies on stock engaged in manufacturing within the state. A four mill tax on loans is placed on all private corporations (which act as the state's agents in collecting the tax from the individual owner) except such loans as are owned by domestic corporations paying the state taxes on capital stock, by national banks, or by non-residents. An 8 mill tax is placed on gross receipts of all transportation and transmission companies, except gas companies, in addition to other taxes. Other corporation taxes are a 2 per cent tax on the premiums of foreign insurance companies (which is re-

[1] Eastman, *op. cit.*, p. 66 *et seq.*

[2] *Ibid.*, p. 81.

[3] *Ibid.*, p. 31 *et seq.*

[4] *Ibid.*, p. 121.

turned to the localities), an eight mill tax on domestic insurance companies, five and four mill taxes on the capital stock, surplus and undivided profits of trust and banking companies respectively; ten mills on distilling companies, and fees of one-fourth to one-third of one per cent for incorporation.[1]

In addition to the receipts from corporation taxes the state has two other large sources of revenue—licenses and the inheritance tax. Until 1913 the personal property tax was also an important source, although, with the exception of the tax on mortgages, it was never successfully enforced. Licenses, particularly mercantile and liquor licenses, have been depended upon from early times for large revenues. They are shared in part with the localities. The inheritance tax was introduced in 1826, when it was imposed on estates of over $250 going to collateral heirs, at the rate of 5 per cent. A direct inheritance tax was introduced in 1897, but was repealed in 1905. The tax on collateral inheritances remains as to rate and exemption as originally enacted. Except for the addition of a tax on anthracite coal imposed in 1913,[2] and a stock-transfer tax imposed in 1915,[3] this system stands without material change today.

2. LOCAL TAXATION

The localities obtain their revenues from taxes on occupations, which are virtually poll taxes, subventions from the state, taxes on real estate, horses and cattle, and, since 1913, vehicles for hire and certain intangible personalty including mortgages and other evidence of indebtedness, stock of corporations not taxed by the state, and all other moneyed capital in the hands of individuals. None of these sources is touched by the state.

[1] *Wealth, Debt and Taxation*, 1913, vol. i, p. 637 *et seq.*

[2] *Ibid.*, p. 642.

[3] *Conference*, 1915, p. 407.

The occupation tax yielded in 1913 only two per cent of all local receipts; subventions amounted to five per cent; and licenses, five per cent.[1] Taxes on realty and personalty supplied nearly half of all receipts. Other important sources were the earnings of public-service enterprises and of general departments, interest and rents.

3. SEPARATION IN PENNSYLVANIA

The history of Pennsylvania's system of taxation, in so far as separation is concerned, may be divided into four periods: (1) the time previous to 1840, when, except for occasional brief intervals, no state direct tax was laid; (2) the period between 1840 and 1866, when the general property tax was the main source of revenues for both the state and localities; (3) the transition period from 1866 to 1885, during which the state relinquished first the real estate tax, and then the tax on horses and cattle, and the localities were deprived of the privilege of taxing such personalty as was directly taxed by the state; and (4) the period since 1885 during which complete separation of revenues has existed.

"Separation of sources" is not, in the strictest interpretation of the term, complete. The inheritance tax paid to the state must be derived in part from the same source as the local tax on real estate; and certain corporations pay a local tax on real estate the value of which is included in the value of the capital stock taxed by the state. But these exceptions are not significant. Most of the corporations paying the capital stock tax are exempt from local taxes on the real estate included in the value of their capital stock. None of the loans taxed by the state is locally taxed and none of

[1] Computed from data in *Wealth, Debt and Taxation*, 1913, vol. ii, pp. 122-123, 466-467.

the personalty taxed by the localities is reached by the state. Separation of source is for all practical purposes complete.

TABLE II[1]

STATE TAXES ON REAL AND PERSONAL PROPERTY, 1841–1915

Date	*Total Receipts*	*Receipts from Realty and Personalty Taxes*	*Percentage of Realty and Personalty Tax Revenues to Total*
1841........	$5,380,800	$33,300	0.6
1845........	3,010,100	1,318,300	43.8
1850........	4,438,100	1,317,800	29.7
1855........	5,390,500	1,721,100	31.9
1860........	3,479,500	1,444,700	41.5
1865........	6,220,000	1,959,200	31.5
1870........	6,336,600	702,200	11.8
1875........	6,480,100	551,300	8.5
1880........	6,720,300	423,700	6.3
1885........	8,179,700	621,000	7.6
1890........	8,625,900	615,900	7.0
1895........	12,030,000	577,000	4.8
1900........	17,494,200	789,800	4.5
1905........	24,269,100	861,700	3.7
1910........	28,895,400	1,117,500	3.9
1915........	30,157,000	....	....

4. EFFECT OF SEPARATION ON LOCAL TAX SYSTEMS

Under this system the real estate tax supplies the localities with their principal, as well as their only elastic source of revenue; and real estate in consequence, as compared with the personalty taxed locally and all of the property taxed by the state, bears a heavy burden. In 1907 real estate paid approximately seventeen mills on assessed value, as compared with the four mill tax on personalty. In 1913 the ratio was eighteen to four. This difference would be even greater if true instead of assessed value were considered, since the greater undervaluation and evasion of personalty result in a lower average ratio of assessed to real value. A conservative estimate would place the value of personalty on a par

[1] Complied from *Reports of the Auditor General.*

with the value of realty, yet the assessed valuation of personalty was only 24.7 per cent of that of realty in 1904.[1] This, even allowing for the fact that much personalty, tangible and intangible, is not taxable in Pennsylvania, is unduly low. One estimate[2] gives the value of taxable personalty returned as 77 per cent of the actual taxable value in 1895; yet, though the increase in the assessed value of personalty has easily kept pace with the increase in the assessed value of realty,[3] less optimistic, and apparently equally reliable estimates[4] give the average ratio of assessed to real value as being well under fifty per cent and possibly only twenty-five per cent. It was estimated to average only twenty-three per cent of actual taxable value in 1912.[5] Realty, on the other hand, was estimated in 1906 to be assessed at from seventeen per cent to one hundred per cent of actual value, with an average a little below sixty per cent. In 1912 the ratio of assessed to true value was estimated to average 58.6 per cent. At this ratio real estate in 1912 was paying a little over eleven mills on actual value, whereas personalty was paying only one mill. The ratio of four to eighteen, taking into account the undesirability of a heavy tax mortgage and the difficulty of reaching personalty under a high rate, may be justified. At least this is the ratio intended by the legislators. But whereas the system

[1] Computed from *Annual Report of the Secretary of Internal Affairs of Pennsylvania*, 1904 (1905), pp. 4-5B.

[2] McCrea, R. C., "Taxation of Personal Property in Pennsylvania," *Quarterly Journal of Economics*, vol. xxi, p. 81 *et seq.*

[3] Taxable realty increased 149 per cent and taxable personalty 209 per cent in the period 1888-1912. *Reports of the Secretary of Internal Affairs* (1880-1915).

[4] E. g., *Secretary of Internal Affairs, Report*, 1904, p. 10B.

[5] *Cf.* the statement of Mr. Weeks, President of the Pennsylvania Tax Conference, that personalty was assessed at only one-fourth of its actual value, 1892. (Weeks, J. D., *Address before the Manufacturers' Association of Cincinnati and Hamilton Co., Ohio*, March 6, 1894, p. 8).

countenances the taxation of real estate at four or five times the rate of personalty, it was not intended that the rate should be ten or eleven times as great. And to this degree the system fails.

Both state and local expenditure, and in consequence state and local revenue, have been increasing rapidly of late. In fifteen years (1899-1914) state expenditures increased 103 per cent.[1] No data for local expenditures are available, but there was a 96 per cent increase in local taxes for this period.[2] The state, even without an elastic tax, has easily met the increase, and in 1913, to relieve real estate taxed locally, it turned over the personal property tax to the counties. The yield of this was approximately five million dollars in 1914. This should reduce the tax on real estate between one and two mills.

But it is not so much the weight of the tax as the inequality which makes the real estate tax burdensome. In 1913, according to the federal census, real estate was assessed at 58.6 per cent of true value.[3] This same average ratio of valuation was given in 1892, in which year variations within counties were estimated at from 20 to 93 per cent. In 1895 estimates were made as follows: range between cities, 16 to 87 per cent; range between boroughs, 22 to 104 per cent; range between counties, 20 to 93 per cent; range between townships, 21 to 95 per cent; range between town lots of one county, 9 to 117 per cent; range between farmlands of one county, 16 to 110 per cent.[4] Many other examples are given, and

[1] Computed from data in *Treasurer's Report* for the years cited.

[2] Computed from data in *Report of the Secretary of Internal Affairs*, for the years cited.

[3] *Wealth, Debt and Taxation*, 1913, vol. i, p. 16.

[4] *Pennsylvania Tax Conference, 1895—Selling Price, Assessed Valuation and Taxation of Real Estate in Pennsylvania, passim.*

even though they are extreme cases they are sufficiently frequent to be of serious concern. There is no reason to suppose that inequalities are appreciably less now.

The localities have been assisted somewhat by the state, for, quite contrary to the experience of most states under separation, the state has had ample revenues. This has reduced the tax on real estate, which, although high as compared with that on personalty, is not high compared with the tax rate on real estate in other states. Michigan with a twelve mill tax on the actual value of general property, in 1911, Wisconsin with a thirteen mill tax, in 1913, and New York with a seventeen mill tax, 1914, were all burdening real estate with a heavier tax than Pennsylvania with an eleven mill tax. These differences in the rate on actual value would appear even greater if real estate could be separated from personalty, for this is the average rate, in every case except Pennsylvania, for both realty and personalty, and realty under the general property tax always bears the larger share. Further than this, personalty is more successfully reached in Pennsylvania than in most states with a local general property tax. One-fourth of the value of property taxable under the local personal property tax is reached. In other states, e. g. Illinois [1] and New York,[2] the proportion is much less. Apparently the higher rate on personalty is more than offset by the increased evasion. Better administration or new special taxes will be necessary if it is desired to make personalty pay a larger share. But when it is considered that real estate pays no state taxes, and that the local tax is smaller than elsewhere, it would seem that real estate is not overburdened, and perhaps could

[1] *Cf.* J. A. Fairlie, *Report on the Taxation and Revenue System of Illinois* (1910), p. 2 *et seq.*, p. 37 *et seq.*

[2] *Report of the Joint Legislative Committee on Taxation*, New York, 1916, p. 69.

bear the whole weight of local taxation without serious embarrassment.

5. EFFECT OF SEPARATION ON THE STATE TAX SYSTEM

Turning to the state system under separation, there seems to have been no effort to equalize the burden of state taxes on the corporations. Following the usual custom of states, manufactures have been largely exempted lest they leave the state, and transportation companies, which cannot leave, have been most heavily burdened. There is further inequality in the separate taxation of stocks and bonds. That corporation which has the largest proportion of its capital in stocks pays highest, for the tax on stock is five mills while that on bonds is only four. Further, in so far as the bonds are held by a non-resident, the corporation escapes entirely; for the tax is a tax on the holder, not on the corporation. More than this, the resident holders of the bonds of foreign corporations generally escape, since the state may not collect the tax through the corporations, even though it be doing business in the state, while the resident holder of domestic bonds pays. There are other inequalities which have no apparent economic reason. To cite a specific instance, gas companies are not subject to the gross receipts tax while electric light companies are. The competition between these two classes of corporations makes the tax on electric companies a serious handicap. These inequalities could for the most part be remedied by a gross or, better yet, a net earnings tax widely applied. They are not a fault of separation, and there is no reasonable doubt, judging from the experience of states employing the general property tax, that if these corporations were taxed under the direct tax the inequalities would be magnified many times; and, furthermore, the state would obtain less revenue.

Centralization of administration, which is so widely favored at the present time, has apparently been slightly checked by separation in Pennsylvania. There is nothing to prevent such centralized administration under separation, but there is less incentive in the absence of a state direct tax. The collateral inheritance tax, licenses, and the taxes on writs, wills and deeds, and fees of office are locally administered; but, being state taxes, the administration is carefully supervised by the state auditor general. This was also true of the personal property tax before it was turned over to the localities. But, except for the examination of accounts of county officers by expert accountants under the direction of the auditor general, and the requirement that the county commissioners shall furnish certain statistical information concerning assessments and taxation to the secretary of internal affairs, no attention is paid to local tax administration. Were the real estate and personalty taxes used by the state they would doubtless be subject to the same state control as the other locally administered state taxes. Separation has doubtless retarded central control of local revenue, but it does not prevent it. The need of such control is great, for the local officials are unable, or unwilling, to correct the inequalities of assessment between the different assessment districts of each county on which the county tax is levied, and between the different properties within one assessment district.

The secretary of internal affairs is urging the extension of his powers to give him the right to supervise local assessments and taxation, and to advise local officers and institute proceedings against those who fail to comply with the law. There is no reason why such supervision should not be maintained, though little has thus far been done to obtain it.

Owing to the very effective corporation taxes the state system has been successful from the standpoint of yield.

The corporation taxes may have their shortcomings, but they have at least proved highly productive and state revenues up to the present time have been ample. Ninety per cent of the receipts of the general fund come from taxes and licenses. Seventy per cent of these receipts are corporation taxes. The capital stock tax is especially productive. Its yield in 1915 was nearly thirteen million, being over two-fifths of total receipts; and it exceeded by nearly ten million the yield from any other single source.

TABLE III[1]

IMPORTANT SOURCES OF STATE REVENUES, 1915

Source	*Amount*	*Per cent*
Total, General Fund	$30,157,000	....
Corporations	21,384,000	71
Licenses	3,741,300	12
Inheritances	2,285,400	7
CORPORATION TAXES, 1915		
Total	$21,384,000	100
Capital Stock	12,897,800	60
Corporation Loans	3,253,900	15
Gross Receipts	1,675,200	8
Foreign Insurance Companies	1,894,800	9
Bank Stock	1,082,800	5
Miscellaneous	579,400	3

In consequence of this large yield and relatively light expenditure the state has practically cancelled all debts, and has for twenty-five years enjoyed a considerable net surplus.

Whether or not this surplus has encouraged extravagance is difficult to determine. There has unquestionably been some misuse of funds, but the rise in state expenditure during the decade from 1903 to 1913 in which the surplus kept well above five million, was not abnormal. The increase

[1] Compiled from data in the *Treasurer's Report*, 1915, *passim*.

was one hundred per cent.[1] This is greater than the total increase in state expenditure (68 per cent) in the United States during this period, but is not as great as the increase in a large number of the more developed states which enjoy no surplus. The increase in California was 120 per cent, Connecticut, 131 per cent, New Jersey, 146 per cent, Wisconsin, 167 per cent, and New York, 222 per cent.

Large surpluses are likely to prove as embarrassing as deficits, but the growing expenditure in Pennsylvania, and the state's policy of turning revenues over to the localities, will probably keep this surplus low. It has decreased in the past five years. In fact there is a very real danger that expenditures will shortly overtake revenues. But whether the state experiences a surplus or a deficit, it cannot hope to make revenues conform to expenditures in the absence of an elastic tax. The natural increase in revenues, following the development of corporations, will correspond only crudely to growth in expenditures. Only through frequently devising new sources or giving up old ones, together with the alternate accumulation and paying off of a debt, which is at best a clumsy method, can the state under the present system attain any real adjustment of revenues to expenditures. Judging from the experience of other states an elastic tax would seem sooner or later to be inevitable. Pennsylvania has never had such a source and apparently has not suffered in consequence. Without an undue amount of legislation revenues regularly balanced expenditures until the large debt had been nearly paid off. This is explained by the fact that expenditures were adjusted to revenues rather than revenues to expenditures. The enormous debt created between 1825 and 1850 necessitated the creation of the new and more remunerative sources of revenue. As these were

[1] *Wealth, Debt and Taxation*, 1913, vol. ii, pp. 40-43.

developed and made to yield increasing revenues the payment of the debt each year absorbed every dollar that could be spared from regular expenditure. Not until 1891 did a surplus arise, and since that time there has not been the same close correspondence between revenue and expenditure. The two must be brought into practical agreement. Any further attempt to adjust expenditure to revenue is likely to lead to extravagance, or to equally undesirable parsimony. If revenues are to be adjusted to expenditures an elastic tax would seem to be the only solution.

CHAPTER IV

Separation in New York

I. HISTORY OF THE GENERAL PROPERTY TAX

New York, following the precedent set by Pennsylvania,[1] embarked in 1880 on a policy of corporation taxation which led eventually to almost complete separation.

The general property tax was at this time—and had been for some years—supplying the state with most of its revenues ($6,169,700 in 1879, which was 87 per cent of the receipts of the general fund of that year, and 99 per cent of all taxes).[2] This tax did not, however, become an integral part of the New York tax system in the early history of the state, as was the case in the New England states. Although regularly used by the localities before 1850 it was employed by the state only in case of emergency. Thus it was levied in 1799 when large borrowing for current expenses made it necessary for three years; and again in 1815 when it was resorted to to pay off the large debt which had accumulated as the result of the policy of borrowing money to meet appropriations whenever they exceeded revenues.[3] Having paid off this debt in 1826, the tax was discontinued in spite of large canal expenditure and growing yearly deficits.[4]

[1] D. C. Sowers, "Financial History of New York State," 1798-1912, *Columbia University Studies in History, Economics and Public Law* (New York, 1914), vol. lvii, no. 2, p. 152.

[2] Computed from data in Sowers, *op. cit.*, pp. 328-329.

[3] *Ibid.*, pp. 114-115.

[4] Possibily because of the growing canal expenditure, since those interested in the development of the canal feared by a direct tax to call the heavy expenditure to the attention of the people.

It was not until 1842 that the growing burden from canal and railway debt made it necessary again to have recourse to the general property tax for state purposes, and the "stop and tax law" of one mill on real and personal estate was then enacted. This tax soon became the most important part of the system. It was continued at a varying but comparatively low rate until 1857, when the rate rose to three mills; and in the years during and after the Civil War it was increased rapidly, until in 1872 it reached the excessive rate of 9.4 mills, — making the entire burden on general property, for state and local taxes, thirty mills, as compared with seven mills in 1852.[1] This burden was not of course borne with equanimity. The always flagrant evils of the state general property tax were exaggerated by the high rate. But objections were for long unavailing.

The general property tax was from its inception a source of complaint from the comptrollers. As early as 1844 the comptroller was conscious of inequalities between the counties, but he confidently expected the tax to encourage economy so that the need for it would be of short duration.[2] It was originally imposed as a temporary measure, to be discontinued when the canal revenues should exceed the canal expenditures by more than one-third of the interest due on the canal debt.[3] But, although this condition was attained in 1845, the levy continued, and with the rise in the rate the complaints became more insistent.[4] At one time it was the unjustifiable exemptions extended to corporations which were emphasized; again it was the discrimination in favor of personalty through permitting the deduc-

[1] *Report of the Joint Legislative Committee on Taxation* (New York, 1916), p. 1.

[2] *Report of the Comptroller*, New York, 1844, p. 76.

[3] *Tax Law*, New York, 1842, ch. cxiv, sec. 9.

[4] *Ibid.*, 1848, p. 21.

tion of debts. One year it was inequalities in the rate of valuation between the different counties of other tax districts which caused dissatisfaction; another year it was the general evasion of the tax by personalty. In 1854 the difficulty of the local assessment of railway property was the principal grievance; in 1857, the law having been changed, the self-assessment permitted to railroads was scored as being manifestly unjust. The total escape of the personal property of corporations, through the prevailing practice of designating as the location of the head office some out of the way place where the assessor was totally unaware of the corporation's existence, later caused complaint; and the difficulty of getting prompt payments from the county treasurers was a constant source of annoyance.[1]

As the defects were pointed out remedies were suggested, mostly in the administration of the tax. The changes urged most frequently were central assessment of corporations by the state comptroller, wider powers of supervision by the state board of equalization, and abolition of special exemptions to corporations and of deductions for debts from personalty. No really radical changes were advocated, though the possibilities of indirect taxation were at times discussed and one comptroller even suggested the feasibility of an income tax at some later date.[2]

County boards of equalization had existed since the beginning of the century, but they had no power to touch the inequalities between counties. In 1859 a state board was created to deal with these inequalities, but its powers were so narrow that it proved entirely ineffective. The legislature appointed committees of investigation in 1862, and again in 1870, but no action was taken on their recommen-

[1] *Cf. Report of the Comptroller*, New York, 1854-1873.

[2] *Ibid.*, 1865, p. 46.

dations.[1] Far from alleviating financial conditions, the legislature instead aggravated them. As early as 1852 the comptroller pointed out that expenditures tended to overreach revenues,[2] and that official in 1854 complained that the legislature showed a "tendency towards a very liberal use of public money," [3] but he found comfort in the belief that the direct tax would soon arrest extravagance. His successor, however, doubted the value of this check.[4] In 1875 the comptroller charged that the annual supply bill contained many unjustifiable claims; that the heavy expenditure for public buildings following the Civil War was unnecessary; that the canal expenditure covered much that was not legitimate; and that subventions to private charities were abused. But while the extravagance of the legislature was repeatedly deplored no effort was made to retrench, and for a time the legislature did not even authorize the necessary taxes to cover the generous appropriations it made. But meanwhile a substantial reduction of the debt was being effected, and the legislature in 1871 began to authorize the proper taxes. After 1873 an appreciable retrenchment in appropriations was noticeable, so that it was possible to lighten the heavy state tax on property until in 1880 it had fallen to 3.5 mills.

In this year for the first time definite action was taken toward improving the state system by introducing special corporation taxes, and reducing the objectionable general property tax accordingly. This act launched the state on a program of taxation which, through the adoption of special taxes for state purposes with a corresponding cutting down

[1] *Report of the Tax Commissioners*, New York, 1897, p. 7.

[2] *Report of the Comptroller*, New York, 1852, p. 7.

[3] *Ibid.*, 1854, p. 9.

[4] *Ibid.*, 1855, p. 13.

of the general property tax, eventually led to separation.[1] From this year onward the state became increasingly less dependent on the general property tax until, in 1906, it was found possible to abandon it altogether. For five years the state derived sufficient revenues from special taxes, but once more the growth of the canal debt—this time supplemented by large highway expenditures—forced the state to resort to the direct tax.

2. HISTORY OF SPECIAL TAXATION AND THE PRESENT SYSTEM

Before 1880 special taxes had never played an important part in the state's finances. In 1823 a special tax had been placed on bank stock, notes, bonds and mortgages, to be paid by the banks and divided in part among the several counties according to the residence of the stockholders. This law, which stands almost alone as an attempt to devise special taxes in this early period, was found difficult to enforce and proved to be a small and rapidly diminishing source of revenue.

In the first half-century of the state's existence it was largely supported by the proceeds from the sale of public lands, and from state investments—the former source supplying for a few years over half of the state's income, and the latter in the early years of the nineteenth century from one-half to one-third of all revenue.[2] Lotteries, which were at times resorted to for special purposes, e. g., education, roads and charities, were found to be very remunerative, and auction duties for a time yielded from one-fifth to one-sixth of the total state revenues. The returns from

[1] While the growth of separation in New York began as an effort to reach personalty through classification, the fact that separation was urged as a reform measure by Professor Seligman and others was unquestionably in part responsible for its final attainment.

[2] Sowers, *op. cit.*, pp. 324-326.

this last source, together with the proceeds of salt works and a special steamboat tax, were for a time diverted to the insatiable canal fund. The expenses of new departments created by the state for the regulation of banks (1839), railroads (1856), and insurance companies (1859) were easily met by fees levied on the companies concerned. The general property tax, after its introduction in 1842, was expanded to meet the rapidly growing expenditures until it became an intolerable burden, borne only as long as made necessary by an urgent demand for money and the extravagance, unresourcefulness and procrastination of the legislature.

Finally in 1880 a law was enacted levying an annual tax on the franchises of corporations, joint-stock companies or associations doing business in the state.[1] This tax was not comprehensive. It aimed only to reach the intangible property of certain corporations for state purposes. Many corporations were exempted, remaining under the general property tax for state and local purposes. Even those liable continued to pay state taxes on their real estate and local taxes on property in general. The local systems remained unchanged. No property was exempted from local taxes. But the new tax marked a turning point in methods of state taxation, and more than that, it soon yielded large revenues. A great deal of litigation followed the enactment of this law, but with little effect on the yield of the tax. The law was amended wherever it was found defective and the comptroller was granted large powers in enforcing it; so that in time, and with a few changes, it reached most of the corporations liable.[2]

From this beginning the present system of corporation taxation has grown. Briefly it is as follows: An organization tax of one-twentieth of one per cent (with $5 as a

[1] Sowers, *op. cit.*, p. 152 *et seq.* [2] *Ibid.*, p. 152 *et seq.*

minimum) is imposed on every stock corporation incorporated in the state.[1] This tax when originally imposed in 1886 was one-eighth of one per cent, but was reduced in 1901 owing to competition from New Jersey and Connecticut.[2]

Foreign corporations—other than banking, insurance and loan companies—pay a license tax of one-eighth of one per cent on capital employed within the state.[3] This is paid on such capital when the company begins to operate in the state and on any increase in the capital thereafter.

A general franchise tax is imposed on both domestic and foreign corporations, being an annual tax on the franchise of corporations, joint-stock companies or associations doing business in the state, the value of such franchise to be determined by the value of capital stock employed in the state during the year preceding. The law as first enacted (1880) taxed total capital stock, but this was later (1885) amended to make only that portion of the stock used within the state taxable. The present rates are one-fourth of one mill for each one per cent of dividends, based on the par value of capital stock, of every corporation declaring dividends of six per cent or more; 1.5 mills per dollar of capital stock (the value of capital stock being net assets or average selling value according as one or the other is higher) on those corporations declaring dividends of less than six per cent whose assets exceed their liabilities; and three-fourths of one mill per dollar, computed on average selling value, on corporations paying no dividends or insolvent corporations paying less than six per cent.[4]

All banks, trust and savings companies, insurance, title guaranty and surety companies, laundering, manufacturing and mining companies, having at least 40 per cent of their

[1] *Tax Law*, 1915, sec. 180. [2] *Report of the Comptroller*, 1901, p. xxxvi.
[3] *Tax Law*, 1915, sec. 181. [4] *Ibid.*, 1915, sec. 182.

capital stock invested in property in the state, and water, light, heat and power companies are exempt from this tax.[1]

Domestic savings banks have, since 1901, paid a franchise tax of one per cent on par value of surplus and undivided earnings.[2] Foreign bankers are subject to a tax of five per cent on interest or other earnings on money employed within the state.[3] Domestic trust companies pay a franchise tax of one per cent on average capital stock, surplus and undivided profits.[4] National and state banks have paid, since 1901, a tax of one per cent on average capital stock, surplus and undivided profits assessed to the shareholders at the place where the bank is located.[5] This tax is distributed among the different tax districts according to the proportion that the tax rate of each district bears to the total tax rate, including county and state, of property in that district. Individual bankers pay no special state tax.

Insurance companies, which were first specially taxed in 1880, have been subjected since to taxes on gross premiums at frequently changing rates and with varying exemptions. The rates vary and are based upon gross premiums for business done within the state. Life, casualty and health insurance companies of the United States pay one per cent on premiums; those of foreign countries pay two per cent. Domestic (New York) fire insurance companies pay one per cent to the state; those of foreign countries pay one-half of one per cent. (Fire insurance corporations of other states or countries pay also two per cent to local fire departments.) Domestic marine insurance companies pay one per cent; those of other states, two per cent; and those of foreign countries, 2.5 per cent. Surety companies pay one per cent. Fraternal and mutual benefit associations are exempt

[1] *New York Tax Law*, 1915, sec. 183.

[2] *Ibid.*, sec. 189.

[3] *Ibid.*, sec. 192.

[4] *Ibid.*, sec. 188.

[5] *Ibid.*, sec. 24.

from this tax. Domestic mutual life-insurance companies are exempt from the personal property tax.[1]

Water, light, heat and power companies have, since 1899, been taxed one-half of one per cent on gross earnings within the state and three per cent on dividends in excess of four per cent declared on paid-up capital.[2]

Elevated and surface railways not operated by steam pay a state tax of one per cent on gross earnings within the state plus three per cent on dividends in excess of four per cent declared on paid-up capital. A leased railroad pays only the tax on dividends.[3]

All other transportation and transmission companies must pay a tax of one-half of one per cent on gross earnings from intrastate business. This is in addition to the capital stock tax, state taxes on real estate and local general property taxes.[4]

Special franchises are classified as real estate, and are assessed by the state tax commissioners,—such special franchises being the value of the privilege of using streets and highways, together with the value of real estate and tangible property thereon. These special franchises are placed on the local rolls and taxed locally at the same rate as other property. Other real estate of corporations is separately assessed by the local officials.

Corporations are further subject to the general property tax of the various local taxing districts in which they are located. In consequence some corporations are paying as many as eleven different kinds of taxes.[5] The inexcusable ambiguity of many of the laws adds to the confusion of this system.

[1] *New York Tax Law*, 1915, sec. 187.

[2] *Ibid.*, sec. 186.

[3] *Ibid.*, sec. 185.

[4] *Ibid.*, sec. 184.

[5] *Conference*, 1909, p. 182.

In developing a system of special taxes New York has by no means confined herself to corporation taxes. Other sources, some of which have at times proven even more lucrative than the corporation taxes, have been developed.

The first of these is the inheritance tax. A law was passed in 1885 which placed a tax of five per cent on all bequests to collateral heirs where the estate exceeded $500.[1] This remained with slight alterations until 1892 when a tax of one per cent was placed on all estates over $10,000 going to direct heirs. No important changes were made after this until 1910 in which year the law was completely revised. The tax was graduated, running as high as twenty-five per cent.[2] But the next year it was again revised and brought down to a more moderate scale. As it now stands the basis of the tax is the individual bequest, not the total estate. The exemption for direct heirs is $5,000, for collateral $1,000. The rate on direct heirs is one to four per cent, and on collateral heirs, five to eight per cent.[3] This applies to all tangible property in the state and intangible property of residents only.[4]

In 1887 a five per cent tax was levied on gross receipts from admissions to race tracks. This grew to yield a considerable revenue, but the proceeds were used for prizes at county fairs, not for general expenditure.[5] It was repealed in 1910.

An excise tax placed on liquor in 1896 yields large revenues. A slight income was obtained from this source beginning in 1892, but with the establishment of a state license system in 1896 with charges according to the character of

[1] Sowers, *op. cit.*, p. 169. [2] *Conference*, 1910, p. 302.

[3] *Tax Law*, 1915, sec. 220.

[4] Before 1911 the state had attempted to tax the intangible property of non-residents also.

[5] Sowers, *op. cit.*, p. 178.

the business and the population of the city where it was located, the yield to the state rose to over $3,500,000, and has been growing steadily since. This is collected by the state and half of the proceeds are redistributed among the localities.[1]

A motor vehicle tax of $5 to $25 [2] first imposed in 1904, now yields a considerable revenue which goes entirely to the state.

In 1905 a tax was laid on all transfers of shares of stock at the rate of two per cent on $100 par value. This has become an important source. Also in 1905 a mortgage tax law was first passed levying an annual tax of one-half of one per cent on all recorded mortgages. It yielded to the state nearly half a million dollars the first year. It was changed in 1906 to a recording tax of one-half of one per cent.[3] By 1915 it was producing over $3,000,000, half of which was retained by the state.

Finally, in 1911, a secured debt tax law was passed, substituting a low rate tax for the ineffective personal property tax on securities. The rate was made one half of one per cent of face value.[4] In 1915, and again in 1916, this law was amended so that secured debts registered before January 1, 1917 might obtain a five-year exemption on the payment of three-fourths of one per cent.[5]

3. EFFECT OF SEPARATION ON THE LOCAL FISCAL SYSTEM

The localities find the present system far from satisfactory. Some cities have raised their rates of assessment slightly. In New York City the rate has been raised to

[1] Sowers, *op. cit.*, p. 177 *et seq.*

[2] *New York Highway Law*, 1915, sec. 282.

[3] *Conference*, 1912, p. 251.

[4] *Ibid.*, 1913, p. 151 *et seq.*

[5] *Ibid.*, 1916, (1917), p. 400.

approximately 100 per cent. This has been done because of the ten per cent debt limit, but such action would not have been taken if there had been any expectation of a return to the state direct tax. Aside from this important exception there is little indication that separation is responsible for any appreciable advance in the ratios of assessment. Rural districts still assess at ratios averaging about 70 per cent. But it is the taxation of personalty which causes the most dissatisfaction. Not only are there varying ratios of assessment for different classes of property in the same district, but also there are varying ratios for the same classes of property in different districts, and even within the same district; further much taxable wealth evades the tax entirely, and much is exempted which should be taxable. The percentage of the total assessment roll represented by personal property varied from less than one per cent to over 21 per cent in fifty-three cities of the state investigated in 1915. Less than one-fourth of these cities obtain more than $2,000 from personal property.[1] The rapid growth of expenditures greatly aggravates these inequalities. But the evils of this system are the evils of the general property tax, not of separation. It is of course conceivable that if the state depended more largely on the general property tax it would have more effective central supervision although as a matter of fact the state general property tax has not in the past brought effective state control with it. The state has the power—and perhaps the duty—even though it derives no revenue from the general property tax, to supervise local assessments; but with no direct financial interest it has not the incentive which it otherwise would have, and it may be that state control has developed more slowly than it would have with a large state direct tax. New York state has never for

[1] *Joint Legislative Committee*, 1916, p. 69.

long been wholly independent of the general property tax. It is impossible to say whether or not greater dependence on this source would have brought more effective supervision of local revenues.

It can be said, however, that separation has brought certain concrete gains to the localities. Unlike Connecticut, Vermont and California, no property has been removed from local taxation, except certain securities, which, though formerly taxable by the localities, were of little consequence since most of them escaped. Following the enactment of the secured debts tax of 1911 the assessed value of personalty taxed locally for local purposes fell five per cent below that of the previous year and between 1911 and 1912 it fell three per cent.[1] To what extent this decrease is due to the exemptions resulting from this law cannot be ascertained. The assessed value of personal property is subject to violent fluctuations entirely apart from exemptions. Between 1900 and 1905, before any exemptions had been made, the variations ranged from a ten per cent decrease to a 22 per cent increase. The removal of mortgages from local assessment, 1906, caused a somewhat heavier decrease; but the localities suffered no loss in consequence, since half of the mortgage tax was refunded to them.[2] To the extent that the state has gone elsewhere for its revenues the local tax system and the local taxpayers have benefited. And since all of the figures indicate that the owner of tangible personalty, as compared with the owner of intangibles, such as corporate stock, was unjustly burdened, the change was beneficial. Assuming that the revenue now derived by the state from special sources would have been obtained in the absence of these from the general property tax, the taxes on

[1] *Cf.* discussion in *Conference*, 1913, pp. 203-204.

[2] *Report of the New York State Tax Commissioners*, 1906, p. 12.

general property were in 1911 approximately 12 per cent less than they would have been under the old system. The actual gain to the taxpayer in 1915 was thirty cents on $100 of taxable property. All of this, of course, he pays to the state in other forms, such as taxes on transfers, or on intangibles which before evaded the tax. But the new taxes, in so far as they are based on income, as is the gross earnings tax, or are progressive, as is the inheritance tax, or reach intangibles which before escaped, more nearly accord with ability.

Concerning the other side of local taxation under separation, viz., the tendency toward extravagance which might result from the removal of the state direct tax, it is difficult to draw any conclusions. The localities depend on the general property tax for from seventy to eighty per cent of their revenues.[1] So it has been the property tax that has in large measure borne the burden resulting from the rapid growth of local expenditures in recent years. Such phenomenal growth is apparent in all of the states, being quite as characteristic of those without separation as of those with. An increase in unnecessary and undesirable expenditure might take place when reductions in the state tax were made, but the very rapid advance of the past few years in New York began shortly before 1900, when the state tax was still nearly three mills, and has not lessened with the return to this tax in the last six years.[2] This does not suggest that local officials have attempted to take advantage of the change.

4. EFFECT OF SEPARATION ON THE STATE FISCAL SYSTEM

The new scheme of taxation, inaugurated in 1880, and since readjusted and enlarged as the exigencies and whims of a moment dictated, is far from satisfactory. The state

[1] Computed from data in *Wealth, Debt and Taxation*, 1913, vol. ii.

[2] *Cf.* data in *Annual Report of the Comptroller*, 1916, pp. 132-135.

drifted toward separation as the line of least resistance. The absence of restrictions in the constitution made special taxes possible, and they were found to be productive and easy to exact. But such a planless, patchwork system, if system it may be called, could not bring equality. It was developed according to no consistent or clearly defined principles, and it had no purpose other than that of obtaining sufficient revenues to meet immediate demands. These revenues it did for a time realize. The legislature continued occasionally to make appropriations without authorizing sufficient taxes to meet them, but in spite of this the debt was practically cancelled by 1892, and however great the dissatisfaction caused by the inequalities of the tax burden, the good financial condition of the state invited delay in remedying them. In 1906 it was found unnecessary to levy a state direct tax, and though the debt was now again growing rapidly the state revenues were so large that the tax commissioners even considered the problem of distributing a surplus among the localities. Such a surplus did not materialize, however, and in a few years the enormous increase in the debt placed heavier demands on the financial system than it could meet. In 1911 it was found necessary to return to the direct tax, which has since supplied a large proportion of the state revenues.[1] Until some decisive action is taken to obtain revenues in some other way this must continue and

[1] Comparison of Direct Taxes and Total State Taxes, New York, 1911–1916.*

Year	*Total Tax*	*Direct Tax*	*Percentage of Direct to Total Taxes*
1911......	$41,473,377	$6,072,766	14.6
1912......	54,730,570	11,022,987	20.1
1913......	50,431,940	6,460,093	12.8
1914......	42,588,418	....	....
1915......	61,244,030	20,519,716	33.5
1916......	53,604,055	....	....

* Compiled from *Reports of the State Tax Commissioners.*

increase. It was estimated in 1915 that the state would need in the immediate future from twenty to thirty million dollars more revenue than the present system has been yielding.[1]

Thus the state has failed to obtain sufficient revenues without the general property tax. The rapid rise in expenditures, due in large part to the interest on the huge canal and highway debts, far exceeded the yield of the regular state sources, and there was no elastic tax to meet the need. This increased expenditure may be extravagant, though the great increase in apparently desirable state activities suggests that for the most part it is not; but whether extravagant or not it is not due to separation. There is no apparent relation between expenditure and the amount of the direct tax in New York. The recent very rapid rise began about 1902 while there was still a state direct tax and with the return to the direct tax there has been no sign of retrenchment.[2] Such rapid increase is characteristic of all of the

[1] *Conference*, 1915, p. 127.

[2] INCREASE IN ORDINARY EXPENDITURES SINCE 1908.*

Year	*Percentage of Increase Over Year Preceding*
1909	15
1910	10
1911	2
1912	15
1913	6
1914	2
1915	11
1916	5[a]
1917	12[b]
1918	13[c]

* *Annual Report oj the Comptroller, 1917*, pp. 304–305; *Annual Tabulation of Statements of Desired Appropriations . . . 1916*, pp. 10–11; *Ibid., 1915*, p. 11.

[a] For nine months only, owing to change in fiscal year.

[b] Based on appropriations, not expenditures.

[c] Estimated from appropriations requested for the years 1917 and 1918.

states in recent years,—those depending on the general property tax for most of their revenues no less than those restricting its use.

With respect to the readjustment of the burden of taxation under separation some gains have been realized, although there is still much to be desired. There has been no great improvement in administration. The assessed value of property varies from 52 to 93 per cent of real value between the different counties, which is about the usual variation, and within the counties the differences are even greater. According to the state board of equalization the average ratio of assessed to true value of realty was 86 per cent in 1915.[1] The need of enlarged powers of the tax commissioners is imperative. The power to order reassessments when necessary, and the removal from local jurisdiction of the assessment of the property of public utilities would benefit much;[2] but so far apparently the incentive to obtain low rates of assessment on real estate and to evade altogether the tax on personalty, which comes with the rise in the tax rate, has more than offset the gains from improved administrative machinery, and it is doubtful if, with the present heavy taxes, changed administrative methods will be effective. According to the recent report of the Joint Legislative Committee a personal property tax at a two per cent rate cannot be generally enforced and, in the few cases where it is levied, is most unjust.[3] The average tax rate for the state for the year 1914 was \$1.90 per \$100, varying from \$1.77 to \$6.56.[4] Thus little gain has been

[1] The high average is due to the fact that two-thirds of the value of real estate is in the City of New York, where assessments are much nearer full value than elsewhere in the state.

[2] *Conference*, 1913, p. 188.

[3] *Joint Legislative Committee*, 1916, p. 9.

[4] Computed from data in *Report of Tax Commissioners*, 1914, p. 55.

realized from administrative reform, and little apparently can be hoped for unless by this means the base of the tax is sufficiently broadened to permit a decided decrease in the rate.

But the burden of taxation has been in part shifted from the general property tax to specific taxes, and in so far as this has occurred the change has been advantageous to the owners of real estate, for it means a lightening of the burden on realty at the expense of personalty. Realty still bears the larger share, however. It is generally conceded that taxable personalty equals, if it does not exceed, taxable realty in value, and that the ratio of personalty to realty—taxable as well as total—is rising.[1] Yet in 1915 the personalty assessed under the general property tax (including bank stock) was only eight per cent of the total assessment roll.[2] In 1905, before any personalty had been removed from local assessment, this equaled ten per cent. In 1870 it was twenty-two per cent.[3] The personalty remaining under the general property tax is escaping in increasing amounts. More special taxes are needed. It was estimated in 1913 that approximately $10,000,000,000 in personalty was not taxed at all.[4] Of course if this were actually reached there would be many cases of double taxation, but such double taxation, e. g., of bonds and of the property which they represent, is consistent with the present tax law. Under present conditions the general property tax is little more than a realty tax. And only in so far as special taxes are employed to reach personalty is realty relieved. In 1915 special taxes yielded approximately $37,000,000. To this extent the new system is advantageous.[5]

[1] *Report of Joint Legislative Committee*, 1916, p. 67.

[2] *Report of the Tax Commissioners*, 1915, pp. 56-57.

[3] Computed from data in *Report of Tax Commissioners*, 1915.

[4] *Conference*, 1913, p. 148.

[5] *Cf. Report of State Comptroller*, 1916, p. 127.

There has been keen competition from neighboring states for the large corporate wealth operating in New York. The ease with which many corporations can move to New Jersey or Connecticut, owing to the location of the City of New York, has made such competition serious. Furthermore, New Jersey and Delaware have done much to encourage the incorporation of companies within their borders. This has made taxation very difficult, and the special taxes have failed to meet the situation. With the exception of the inheritance, motor-vehicle, excise and stock-transfer taxes, which are apparently both equitable and lucrative, they are most unsatisfactory. The mortgage tax is attacked on the ground that no consideration is taken of the length of time the mortgage is to run, thus placing a heavier burden on the short-term mortgage.[1] This might easily be remedied. The secured-debts tax was objected to because it subjected this class of property to a very low tax which exempted it forever from local taxation. Since this wealth was for the most part evading local taxation this objection was hardly valid; but the small amount of revenue produced and the widespread feeling that it discriminated unfairly in favor of the holders of such property, led to its amendment in 1916. The methods of corporation taxation are, with reason, the most severely condemned. The taxes on banks and insurance companies are held to be too low; the capital stock tax is declared to be unequal and inconsistent—the provisions being such that some wealth is exempt while other wealth of the same kind is subject to taxation;[2] the exemption of mining, laundering and manufacturing corporations, particularly the last, is inexcusable.[3] New York is the leading state in manufacturing, yet manufactures pay a smaller percentage of the states taxes than in any other of

[1] *Conference*, 1913, pp. 150-151.

[2] *Ibid.*, p. 86 *et seq.*

[3] *Ibid.*, p. 90.

the important manufacturing states, except Pennsylvania. More than this, in New York the ratio of the percentage of total revenues paid by manufactures to the percentage of total wealth invested in manufactures is smaller than in any other state.[1] The assessment of the special franchise apart from the rest of the corporate property is impossible. The local taxation of capital stock is a farce. Local assessment of the real estate of public utilities is absurd. Such are some of the objections, and they are serious ones. Simplification, centralization, and uniformity are sadly needed. But there is no reason why they should not be realized. Separation does not prevent their attainment. California under complete separation has met these difficulties with fair success. With the equalization of these corporation taxes through a gross or net earnings tax, revenues could be greatly increased without in the least injuring the taxpayers. Taxes in New York are very high, but wealth in New York is enormous. It is the inequalities rather than the amount of the taxes that work hardship. The Joint Legislative Committee has recommended to cure these inequalities (1) the abolition of the personal property tax; (2) the withdrawal of general business corporations from the capital stock tax; and (3) the imposition of an income tax on individuals and general business corporations.[2] Such changes, in addition to obtaining greater justice, ought greatly to increase the yield of revenue; and an increase in revenue would again permit, for a time at least, the abolition of the direct tax.

In spite of their defects the present special taxes are reaching wealth far better than the general property tax alone could have done. It has been estimated that to obtain the same amount of revenue from personalty as was ob-

[1] *Joint Legislative Committee*, p. 132. [2] *Ibid.*, p. 207.

tained from special taxes in 1912 would have required a two per cent rate on a personalty assessment roll nearly three times as large as the largest ever known in the state.[1] It is scarcely conceivable that this could have been obtained under the general property tax. The continuing inequalities in assessment, which persist in spite of improved administrative laws and the efforts of the tax commissioners, and the increasing escape of personalty throw the burden of the general property tax more and more on real estate. If the present amount of revenue from special taxes could be derived from the general property tax the burden on real estate would be intolerable. Real estate is already paying a heavy tax, amounting in New York city to from thirty to forty per cent of its net income.[2]

Whatever the inequalities of the new system, they are less flagrant than those of the former system. Separation has brought no new evils. It has cured, or at least ameliorated, some of the old. But there is one defect which has so far prevented the continuance of separation. Having given up the general property tax, the state is left with no elastic tax, and without one it is exceedingly difficult to make revenues conform to needs. This difficulty has not been surmounted in New York. Hence it has been found impossible to enjoy permanent separation of revenues.

[1] *Conference*, 1913, pp. 198-199.

[2] *Joint Legislative Committee*, pp. 17-18.

CHAPTER V

Separation in Connecticut

1. HISTORY OF TAXATION IN CONNECTICUT BEFORE 1889

Separation was introduced into Connecticut by legislative act in 1890.[1] Previous to this date the direct tax, while declining in importance, had been regularly employed. Until 1819 the direct tax had taken the form of a tax on incomes, only a part of which—that representing gains from business and professions — was estimated by assessors.[2] The income from real estate was determined by the law itself, which classified land and buildings and estimated incomes accordingly.[3] Over these the assessor had no control, and whatever inequalities may have existed—and under such crude classification there must have been many—were between individuals and not localities, and the vexing problem of the state equalization of assessments did not arise.

But following the adoption of the state constitution of 1819 the tax system was changed. Capital value was substituted for income as the base of the tax,[4] and the determination of such value was placed in the hands of local

[1] *Report of the Treasurer for 1890* (Hartford, 1890), p. 7. (There are no constitutional limitations on taxation in Connecticut.)

[2] *Report of Special Commission on Taxation in Connecticut* (New Haven, 1887), p. 9 *et seq.*

[3] Land was valued according as it was classified as meadow, plough-land, pasture, wood-lots,—and buildings according to size, materials and number of fire-places. (*Report of Special Commission*, pp. 9-10.)

[4] *Ibid.*, p. 10.

assessors, state and local divisions alike using the same valuations. The statute provided for assessment at fair market value, but little effort was made to enforce it. Inequalities arose at once. The practice of assessing property at two-thirds of its market value, or even lower, became general, and not only did different assessors employ different rates but the same assessors used different rates for different classes of property. In 1821, when the new system had been in operation only two years, a state board of equalization composed of the treasurer and the comptroller was created to remedy matters.[1] These officers, although given the power to raise or lower, in part or as a whole, the assessment lists of the towns (the local units of assessment), accomplished nothing — for they had many other duties to perform, and were not authorized to visit the different towns for purposes of assessment.

With the hope of improving matters a committee, appointed by the general assembly, made an investigation in 1843 and 1844, but concluded that the serious inequalities lay, not between different towns, since the state tax was relatively light, but between different individuals; and proposed as a remedy the abolition of the state board of equalization and the valuation of property by the owners themselves—such valuations being made public.[2] No action was taken on these recommendations. Taxation was not yet so burdensome that inequalities were deeply felt.

In 1866 again an attempt was made to render the state board of equalization effective.[3] A commissioner from each senatorial district was appointed to examine the grand lists of the district, and if necessary to make a personal investigation of the property itself, reporting the facts to the

[1] *Report of Special Commission*, p. 10.

[2] *Ibid.*, p. 11.

[3] *Ibid.*, p. 12.

board. The next year, 1867, these district commissioners were dropped from the state board of equalization, but were required to assess (together with a selectman from each town) representative homesteads and farms. The value of all property was then estimated on the basis of these valuations. These estimates were then compared with those of the assessor and reported to the comptroller. But these changes accomplished nothing, the local officers appointed to investigate being subject to the same influences as the local assessors to keep valuations low. The act was repealed in 1871.[1]

A commission of investigation which was appointed at the same time, 1867, appreciating this difficulty, recommended centralization through a state tax commissioner with power to appoint the assessors for each town. This latter recommendation was before the assembly again in 1876 and once more (by approval of a temporary tax commission) in 1881 but was not adopted. A fourth attempt in 1887 was also unsuccessful, and not until 1905 was this step finally taken. The tax commissioner then appointed was granted the power to visit towns to make his investigations, but not to appoint assessors, there being no state direct tax at this time.[2] After 1887 no more investigating commissions were appointed, and, failing to obtain central control, those seeking reform turned to separation, by which it was hoped to obtain equal assessments, or at least to avoid the injustice of unequal assessments.[3]

The special commission reporting in 1887, which recommended the creation of a tax commission, had disapproved of the removal of the state direct tax, which it considered to be a check on extravagance, but its investigations showed

[1] *Report of Special Commission*, p. 14.

[2] *Tax Law of Connecticut*, 1906, sec. 2413.

[3] Governor Bulkeley, *Message to the General Assembly*, January, 1889.

wide variations in the ratios of assessed to real values in the different towns and between different classes of property.[1] To avoid this evil it favored apportionment according to population. No action was taken upon this recommendation.

In 1889 a new collaterial inheritance tax was imposed, and the method of taxing express, telegraph and telephone companies was changed. Also, by an investment tax law, certain personal property, before escaping, was reserved exclusively for state purposes. These changes enabled the general assembly to authorize the treasurer, June 22, 1889, to suspend the state tax payable in November 1890. The primary purpose of this measure was to get rid of unequal assessments.[2]

For nearly twenty years following this change it was not found necessary to revert to the direct tax for state revenues. Under this system the local divisions were given the general property tax for their exclusive use. This tax they were to apply to all property not specifically exempted from taxation or reserved for state purposes.

The changes made by separation and the other financial reforms of that year in the state tax system were not radical. The loss from the general property tax was in large measure offset by the gains from the new collateral inheritance tax and the tax on choses in action. Some of the corporation taxes were considerably altered and somewhat increased, but the subjection of these corporations to special

[1] The average was 67 per cent. In one case unimproved land was assessed at 33 per cent, improved at 60 per cent of actual value. *Report of Special Commission*, p. 9.

[2] The special taxes introduced in 1889 and the changes made in certain corporation taxes in that year (which made it possible to abolish the state general property tax) were the direct result of the recommendations of the Special Commission of 1887. (*Report of the Special Commission, passim.*)

and frequently changing state taxes was an old story.[1] The problem of reaching corporations, particularly public utilities, had arisen early in Connecticut, and special state taxes, first in addition to, and later in place of, the general property tax, were devised to meet the situation.

A modest beginning was made in 1849, when a state tax was imposed on shares of railroad stock owned by non-residents. The following year the rate was reduced and the tax was extended to all shares, wherever owned. In 1862 the rate was raised and horse railways were included. Except for increases in rates, in 1864 and 1865, and a number of deductions, which, to the detriment of the revenues obtained, were permitted from time to time, the tax remained in this form until 1889.

Mutual life-insurance companies and savings banks were next subjected to special taxes. In 1851 insurance companies were taxed on total cash capital due to the companies. The rate of this tax has been changed from time to time, but the base has remained practically the same. Fire-insurance companies were added in 1872.

Savings banks were taxed on deposits in 1851 and were exempted from other taxes. This tax still continued in 1889, although the rate had frequently varied, and increasing deductions had been made. During the period from 1857 to 1875 building associations were included.

The pressure for funds brought about by the Civil War, which resulted in raising the rates of the special taxes already established, also led to the introduction of new taxes. First, in 1862, came a three-fourths of one per cent tax on telegraph companies on all property within the state, to be in lieu of all other taxes. In 1864 this was changed

[1] For a detailed history of the development of corporation taxes see *Report of the Special Commission on the Taxation of Corporations*, 1913, *passim*.

to a tax on every message sent from offices within the state. The next year a third form of taxation was tried, viz., one on all gross receipts collected within the state. This remained until 1889 when a fourth method was introduced, a flat rate per mile of wire.

In 1864 express companies were singled out for special taxation, a tax on gross receipts paid within the state being imposed in lieu of other taxes. The rate was raised in 1865, and again in 1889 when the tax was restricted to gross receipts on business transacted entirely within the state.

Banks were chosen for special legislation in 1866, when a tax was imposed on the market value of stock held by non-residents.

Not until 1882 were telephone companies sufficiently developed to call forth special legislation. In this year they were removed from the general property tax and a tax on gross receipts collected within the state was imposed, to be abandoned in 1889 for a flat rate of seventy cents on transmitters and wire per mile.

This brief account shows not only that Connecticut began early the taxation of corporations, but likewise that she had experimented even before 1890 with practically every conceivable type of special corporation taxes, although such public utilities as car, gas, electric and water companies, and all manufacturing and mercantile corporations were not then included.

In this way the state, during the forty years from 1849 to 1889, gradually removed from local taxation and appropriated for her own use large and increasing sources of revenue. The readjustments which these changes necessitated in the local tax systems could not have been serious—for not only was the change gradual, but the sources appropriated were for the most part unimportant at the time of

appropriation, either being undeveloped or evading in large part the local assessor. Moreover, the problem of local finances only became acute at a much later date.

2. TAX SYSTEM IN 1889

The local systems were not disturbed when separation was accomplished in 1889. The general property tax supplied them with from two-thirds to three-fourths of their revenue at this time, other important sources being local licenses, state subventions for education and poor relief, and earnings of institutions.[1] The changes made in express, telephone and telegraph taxes in this year, of course, had no effect on the localities, since these sources had been long since removed from local taxation. And of the two new state sources created, the inheritance tax exempted no property from local taxation while the low rate tax of two mills on choses in action, although nominally withdrawing a considerable source, in reality took scarcely anything, since the securities reached by this tax had before largely evaded the local assessor. The valuation of choses in action listed before this was not over $3,000,000, and it was even asserted in 1889 that none was listed.[2] Any possible loss resulting could be easily made up by a slight increase in the tax on general property, a move readily justified because of the exemption of such property from state taxation.

The state in 1889 was deriving 22.9 per cent of its revenues ($441,000) from the direct tax, and the remainder ($1,482,900) from separate sources.[3] There had been a tendency toward gradually increasing separation since 1850,

[1] *Quadrennial Report of Indebtedness and Expenditures of Municipalities* (Hartford, 1888), *passim.*

[2] D. B. Chapman, "Inequalities of Town Taxation in Connecticut." A paper read before the New London Board of Trade, Feb. 12, 1889.

[3] Computed from data in *Report of the Treasurer* for 1889 (Hartford, 1889).

as indicated in the above discussion of corporation taxation, and in the ten years preceding 1889 the receipts from the general property tax had declined absolutely as well as relatively.[1]

The largest separate source of revenue in 1879 was the mutual life-insurance company tax, which yielded more than one-third of the revenues from separate sources. Railway taxes came second in importance, and the tax on savings banks and savings departments of trust companies, and the military commutation tax yielded considerable amounts.[2]

In 1889 the railway tax led in importance, with 45.3 per cent, with the savings bank and trust, and the mutual life insurance taxes following, with 16.2 per cent and 15.3 per cent, respectively.[3] The marked fall in the receipts from the latter was due to a decrease in the rate. The commutation tax, while actually yielding larger revenues than in 1879, was proportionally less. During this entire period the taxes on express, telephone, telegraph and mutual life insurance companies yielded considerably less than one per cent each.

3. HISTORY OF TAXATION IN CONNECTICUT DURING THE PERIOD OF COMPLETE SEPARATION

In 1891, with complete separation in force, the state revenues were smaller than they had been before—the increase in old sources and the yield from the new ($81,000 from choses in action and $74,800 from inheritances) being less than the lost general property tax. Owing to these changes there was some alteration in the relative amounts

[1] The amount of the tax was $485,700 in 1879, or 32 per cent of total revenues; in 1889 it was $441,000 or 23 per cent. (*Treasurer's Report*, 1879, 1889).

[2] *Cf. Treasurer's Report*, 1879.

[3] Computed from data in *Report of the Treasurer*, 1889.

from different sources, but there was no radical change, and in 1892, when the new system was fairly well adjusted, it yielded more revenues than the old. The yield has steadily increased since.[1]

The changes of 1889 were only one step, though an important one, in the improvement of Connecticut's finances. The effort to increase the yield of the system, and at the same time to make it more equitable, continued.

In 1893 the tax on shares of stock of steam and horse railways was extended to the stock of all street railways. In 1895 the reimposition of the direct tax was considered, such was the growing need of funds, but no action was taken. The choses in action tax was doubled this year and brought some relief. In 1897 the rate on inheritances was changed from five per cent on bequests over $1,000 going to collateral heirs to three per cent on estates above $10,000; and a tax of one-half of one per cent on estates going to direct heirs, the same exemption being observed, was added. The one per cent tax on the market value of the stock of banks owned by non-residents was extended in 1901 to cover all bank stock, and in addition all stock insurance companies. In 1903, as a concession to equality, the tax on mutual fire-insurance companies was reduced to one-fourth of one per cent, which was the rate on mutual life-insurance companies. The loss in revenue was negligible. A further reduction of revenue, also of slight importance, followed the lowering, in 1905, of the rate on express companies operating on railways within the state from five to two per cent. Experiments in the taxation of estates of non-residents were tried from 1903 to 1907, but with little effect on revenue.[2] In 1907 the telephone tax was raised through advancing the rate on transmitters from seventy cents to $1.10.

[1] *Cf. Treasurer's Report.*

[2] *Conference*, 1908, p. 173 *et seq.*

But all of these changes did little to increase revenues, and extraordinary expenditures, beginning in 1907, made decisive action unavoidable. Such action was taken by the legislature of 1909 which reimposed the state direct tax which had been suspended twenty years before. This tax is voted biennially by the state legislature. It was omitted by the legislature of 1911 but has since been regularly authorized and there seems to be no immediate expectation that it will be given up. Thus separation, temporarily at least, has been abandoned.

4. EFFECTS OF SEPARATION AND RECENT LEGISLATION

The only local effect of separation in Connecticut was to relieve property of the state's share of the general property tax which, in 1888, was approximately 7.5 per cent of the total tax. Since real estate, particularly land, was undoubtedly bearing the larger share of the tax, the shifting of this part of the burden to other sources was a relief to the agricultural districts. The actual local tax in 1892 was indeed higher than the total state and local tax in 1888,[1] but this was apparently due only to normal increase; so, while the burden was greater in 1892 than it had been in 1888, it was unquestionably less than it would have been had the old system prevailed.

There is no indication that the localities took advantage of the change to impose excessive taxes, for the increase in their revenues was normal. The average four-year increase between 1876 and 1912 was thirteen per cent. Between 1888 and 1892 taxes rose twelve per cent, and from 1892, thirteen per cent.[2] Neither is there any indication that the ratio of assessed to real valuations was raised. The rise

[1] *Municipal Debt and Expenditures*, 1888, 1892.

[2] Computed from data in *Municipal Debt and Expenditures*, 1888, 1892, 1896.

in the grand list was not abnormal,[1] but there was the usual advance in the tax rate.[2] In short, the local revenue systems were unaffected by separation.

The primary aim of separation in 1889 was to get greater equality of local assessment ratios, or at least to avoid the evils of inequality and to do away with the need of state equalization.[3] If the success of this reform is to be measured solely by its accomplishment in this respect it must be considered a failure. To be sure, the state tax of one mill (*cf.* total average rate on rural property of 13.3 mills[4] and total average rate on urban property of 24.3 mills) was removed, leaving only the county tax, an almost negligible quantity—never over one mill and generally decidedly less—to be apportioned on the basis of town assessments. But this was the only gain.

In 1907, when complete separation had been in operation sixteen years, and any effects on assessed valuations had had ample time to develop, the inequalities of assessment remained nearly as great as ever. They are not so serious as in many states but they have not been much diminished by separation. Twenty-eight per cent of the towns claimed assessments at one hundred per cent of real value, but more than one-fourth admitted ratios under seventy-five per cent.[5]

[1] The first distinct rise in the grand list came in 1896 when the state board of equalization first undertook revaluation for purposes of state and local taxation.

[2] Average Tax Rate *

Year	*Town*	*Borough*	*City*
1884........	11.66	5.58	10.05
1888........	12.16	5.83	10.90
1892........	12.50	5.97	10.05

* Computed from data given in the *Connecticut Reports on Municipal Debt and Expenditure* of these dates.

[3] *Supra*, p. 74.

[4] Computed from data in *Municipal Debt and Expenditure*, 1888.

[5] *Biennial Report of the Tax Commissioner* (Hartford, 1908), p. 4.

In 1909 fifty-four towns claimed one hundred per cent valuations, but the state board of equalization found cause to make additions to the lists of all but nine of these.[1] To cite an extreme case of variation, buildings were assessed in one town in this year at 33 per cent of true market value, in another at 125 per cent. Further, the variations between different classes of property in the same town were very great. Discrimination in favor of land was sometimes made. More often land was discriminated against. Buildings as a rule were assessed at a slightly lower ratio, while other property, if it did not escape entirely, was usually assessed much lower.[2]

Lengthening the term of office of the assessors from one to three years, and additional pressure brought to bear following the reimposition of the state direct tax, had some effect, so that in 1910 the lists of over one-fifth of all of the towns were accepted unchanged by the state board of equalization. However, even in 1912, although it was claimed that the average ratio for land was 90 per cent, and for buildings 89 per cent, there were instances where these were assessed as low as 50 per cent.[3] The fact that the board of equalization, since 1896, has added anywhere from 7.8 per cent (1905) to 23.4 per cent (1900) to the grand list of the towns is in itself very significant.[4]

The average rate for land in 1908 was approximately 86 per cent, buildings 84 per cent, and other property 73 per cent. This has been slightly raised since, so that now it is

[1] *Biennial Report of the Tax Commissioner* (Hartford, 1910), p. 5.

[2] Manufacturing plants were especially favored at this time, being commonly assessed at 25 per cent. *Biennial Report of the Tax Commissioner*, 1910, p. 35.

[3] *Information Relative to the Assessment and Collection of Taxes* (Connecticut, 1913), *passim*.

[4] *Reports of the State Comptroller*, 1896-1916.

considerably above the average ratio of assessment of 67 per cent of true value assumed to exist in 1889. But the activities of the board of equalization since 1896 and, more recently, of the tax commissioner, especially since the return to the direct tax, are largely responsible, although the existence of separation doubtless made the labors of these officials much less difficult. Also some gain was realized through separation in so far as it relieved property of the inequalities of the slight state tax.

The obvious advantages of special corporation taxes had already been realized in large measure, so that the changes of 1889 made no real progress here, although the new taxes on inheritances and certain securities were a step in advance.

The relief to agricultural districts due to shifting the entire burden of state revenue from general property to specific forms of property, particularly intangibles, was obtained. This was a real gain; and, as explained above,[1] the localities did not take advantage of it to raise their tax rates unduly.

Thus it is seen that no very decided advantages were gained from separation. On the other hand, only one of the evils generally attributed to it, viz., the inelasticity of such a system, was incurred.

Extravagance in state expenditure was not encouraged by the lack of a direct tax. On the contrary, the inelasticity of the system apparently acted as a far more effective check than a direct tax. The new system supplied sufficient revenues for some time. Although the state was forced to suspend its policy of paying off the debt in 1892 and in 1896 the treasurer made an appeal for new sources of revenue,[2] the increase, if rather small, was steady year by year, and the state eventually succeeded, not only in keeping expen-

[1] *Supra*, p. 84.

[2] *Treasurer's Report*, 1896, p. 6.

ditures within revenues, but also in continuing to pay off the debt. No sinking fund was maintained, but an increasing surplus resulted in a falling-off of the net debt beginning with 1898. The reduction of the funded debt was begun in 1900, and so faithfully was this policy pursued that the debt fell from $3,240,000 in 1899 to $844,000 in 1908.[1] This was made possible in part by the restriction of state activities and in part by the steady growth of revenues, the latter being due rather to the development of corporations subject to state taxation than to changes in the tax system. Revenues increased fifty-six per cent in the period 1890 to 1905, as compared with thirty per cent from 1875 to 1890.[2] It seems safe to assume that this increase was, if anything, less than it would have been under a direct tax, for revenues at the beginning of this earlier period had been forced abnormally high to meet the heavy debt remaining from the Civil War. Moreover, the later period was one of rapidly growing expenditure throughout the country. Connecticut was not obtaining excessive revenues and was not pursuing a spendthrift policy; but rather was practising strict, possibly even unwise, economy, in order to reduce her debt and keep outgo below income. And so successful was this policy that in 1907 the cash balance in the treasury exceeded the funded debt and an actual surplus was realized.

This prosperous condition of the treasury was of short duration. That same year the legislature authorized bonds to the extent of $6,500,000 for highways, armories, libraries and other public buildings. This has since been followed, under protest from the treasurer,[3] by the authoriza-

[1] *Treasurer's Report*, 1899-1908.

[2] Computed from data in *Treasurer's Reports*, 1875, 1890, 1905.

[3] *Ibid.*, 1912, p. 6.

tion of further issues, until the funded debt in 1915 exceeded $13,000,000.

The burden of interest which this saddled on the state, together with increases in appropriations for other purposes, increased expenditures to such a point that the financial system of the state was unable to meet the situation. Moreover, the freeing of the toll bridges in 1907, and the changes in the inheritance tax, and military commutation and poll tax, of 1909, only aggravated matters, and it was found necessary to resort to temporary loans. Thus the legislature of that year was forced to authorize the levy of a direct tax of 1.5 mills for 1910 and 1911 in order to alleviate conditions.

The lack of an elastic source of revenue was the real defect of separation. The direct tax was not continued in 1912 and 1913, much to the distress of the treasurer, but was again authorized in 1914 and 1915 at the rate of one mill. In this latter year it supplied 17 per cent of all revenue, being the largest single source.

In spite of this the debt has continued to rise, and other revenue sources and systems have been eagerly sought, with the result that in 1913 a gross earnings tax was introduced for telegraph companies at 3 per cent, telephone companies at 4 per cent, and car companies, which had never before been subjected to a special state tax, at 2 per cent. Also the tax on gross earnings of express companies, though it was reduced to 2 per cent for all companies, was extended to the state's share of gross receipts on interstate business.[1]

These changes were followed in 1915 by the application of the same gross receipts tax at the rate of 3.5 per cent to steam railroads, 4.5 per cent to electric railroads, and 1.5 per cent to gas, electric and power companies. These latter

[1] *Conference*, 1912, p. 306.

were not removed from the general property tax. Manufacturing and mercantile corporations were subjected to a state tax of 2 per cent on net incomes in addition to the local general property tax. The low rate tax on intangibles was made more effective by attaching a 10 per cent penalty to estates the securities of which had been evading the four-mill tax. Further, apportionment by expenditure was introduced to be applied to the direct tax, in the hope of avoiding the injustice of unequal assessments and gaining greater equality. And to prevent the danger of further unwise legislation a finance board was created, comprising thirteen members (three citizens, three state officials and seven members of the legislature), to act as budget committee during its session. All appropriations are referred to this board and its recommendations are reported to the legislature for action.[1]

Thus while continuing to increase the number and yield of separate state taxes, Connecticut has practically abandoned complete separation. Some slight relief to the rural districts was obtained by this system. But it did not bring, of itself, as had been hoped, assessments at full value, and the gain which it did realize of avoiding some of the evils of these inequalities through the removal of the state tax can be attained equally well through apportionment by expenditure.

Separation did not induce extravagance, nor did the localities suffer, but the inelasticity of state revenues under the system led to its abandonment.

The direct tax is authorized by the legislature for only two years at a time, and of course may at any time be dropped, particularly if the new sources of revenue prove fertile. But, with the state debt growing as it is at present,

[1] *Conference*, 1915, p. 416.

it is hardly probable that the direct tax will be omitted for any length of time. If some other elastic source were substituted, such as a state income tax (which has been considered), sufficient revenues might be produced to reëstablish separation; although its continuance for any length of time would be doubtful unless the rate were made variable. It does not seem probable, however, that such a tax will be introduced in the near future. The general property tax, since the adoption of apportionment by expenditure, is apparently giving great satisfaction.[1]

Should an income tax be introduced, the tendency toward centralization might lead very possibly to the use of such a tax locally as well as by the state. The general property tax is unsatisfactory for local purposes, and it is not inconceivable that the localities should be allowed to make additions to a state income tax were the state to adopt one.

It seems, therefore, improbable that complete separation will be used again in Connecticut for any long period of time. But the present method of employing a large number of special state taxes, which entails a considerable degree of separation, will doubtless be retained for some time, and it is most unlikely that the state will ever return to the old general property tax levied on the basis of local assessments. Separation, as suggested above,[2] has been used as a stepping-stone to better methods, not as an end in itself.

[1] According to the tax commissioner, Mr. William H. Corbin, the extension of the income tax on manufacturing and mercantile corporations to the personal property of these corporations now subject to the local general property tax is being considered; but there is no expectation of extending it further than this, nor of giving up the state general property tax as now levied.

[2] *Supra*, p. 11.

CHAPTER VI

Partial Separation in New Jersey

I. STATE AND LOCAL TAX SYSTEM

New Jersey has levied no direct tax since 1884, with the exception of a state school tax, which is returned entirely to the counties. Before 1851 the state depended for the most part on special taxes. These first took the form of taxes on land—the valuation of which was determined by law—personal taxes, and taxes on special forms of tangible property. Later bank stock was reached, and then other intangibles. In 1851 most of the special taxes were replaced by a general property tax,[1] — apparently the result of the influence of neighboring states and pressure for increased revenues, although New Jersey never became as seriously involved in debt as did some of her neighbor states during the period of state development of internal improvements. The tax was not regularly levied until the time of the Civil War. The proceeds of this tax were at first diverted for the most part to the War Fund; later, beginning in 1872, they were used principally for school purposes, and after 1884 they were devoted entirely to this purpose. But for nearly twenty years the general property tax was also an important item in the state fund, yielding, in 1878, 49 per cent of the total receipts of that fund.

[1] J. M. Mathews, "Tax Administration in New Jersey," *Journal of Political Economy*, vol. xx, p. 725.

TABLE IV[1]

PERCENTAGE OF RECEIPTS OF THE STATE FUND DERIVED FROM THE GENERAL PROPERTY TAX

Date	*State Fund*	*General Property Tax*	*Per cent State Fund*
1870......	$868,800	$190,000	22
1875......	1,463,300	660,700	41
1880......	1,106,500	254,700	23
1885......	1,272,800	21,900*	2
1890......	1,830,900	....	..

* Deficiency tax (state tax of 1882).

This was New Jersey's only experience with a general property tax for state purposes, for the state school tax may properly be considered a local tax since the counties get it all back—and nine-tenths of it in proportion to assessed valuations. It is subject only to the objections of a local general property tax, and not to the additional evils to which such a state tax is liable. Consequently separation of revenues, practically, if not technically, is complete. The state derives its income almost entirely from railroad, canal and other corporation taxes.

A tax on the capital stock of banks, first levied in 1810, was the beginning of corporation taxation in New Jersey. It was a tax on the shareholders, but collected through the banks. In 1826 foreign insurance companies were taxed on gross premiums, and later domestic insurance companies were taxed on capital stock.[2] In 1830 provision was made for flat rate taxes to be paid by railroad and canal companies in proportion to the passengers and freight carried. This law was amended many times and by 1849 had been converted into a tax on cost of construction, to be levied annually on all railroads and canals after earnings had reached six per cent of such cost. The provisions for the enforce-

[1] Compiled from *Annual Reports of the Comptroller of the Treasury*, 1865-1890.

[2] Mathews, *op. cit.*, p. 724.

ment of this act were so ineffective that the companies were practically permitted to assess themselves. In 1873 a commissioner of railroad taxation was first appointed to make assessments for local taxation of railroad property other than the "main stem," which was reserved for state taxation. In 1876 this officer was superseded by a board of railroad commissioners to value all property, and the state tax was thereafter levied on "true value" instead of on cost of construction.[1]

In 1884 the railroad and canal taxes were revised. All property, including the franchise, was made subject to the state tax [2] and in addition real estate other than the "main stem" was subjected to a local tax at the rate of other property locally taxed, but not to exceed one per cent. In 1897 the state revenues from that real estate which was subject both to state and local taxation were turned over to the localities. In 1906 the fixed state rate was replaced by a variable rate equal to the average tax rate on property throughout the state.[3] Except for some minor changes in 1908 this tax remains today.

Other corporations were taxed under laws of 1884 and 1892. At present there is a state franchise tax on gross earnings or gross premiums,—of one-half of one per cent on the gross earnings of gas and electric companies not using the public highways; thirty-five one-hundredths of one per cent on gross premiums of domestic life-insurance companies with one per cent additional on any surplus; and two per cent on the gross earnings of certain car companies and express companies.[4]

[1] Mathews, *op. cit.*, pp. 725-726.

[2] The rate remained, as it had been before, one-half of one per cent.

[3] Mathews, *op. cit.*, p. 726.

[4] For more detailed discussion of corporation taxation see *Wealth, Debt and Taxation*, vol. i, p. 595 *et seq.*

All domestic corporations not paying this gross receipts tax or the local gross earnings tax, railroad and canal companies, or insurance companies subject to special taxes, are subject to an annual franchise tax of one-tenth of one per cent on capital stock issued and outstanding up to three million dollars. All capital stock between three and five million is taxed one-twentieth of one per cent and each million or fraction thereof above five is taxed a flat rate of $50. Manufacturing and mining corporations at least fifty per cent of whose capital stock is invested in manufacturing or mining within the state are subject to no special tax. Those with less than fifty per cent of capital stock invested within the state may deduct such stock from total stock before being subjected to a special tax.

Foreign fire-insurance companies are assessed two per cent on gross premiums, with a retaliatory tax for those states with higher rates than New Jersey. Foreign life-insurance companies are subject only to the retaliatory tax. All others, except domestic life insurance, which are taxed under the state franchise tax on gross earnings, pay two per cent on gross premiums.

Corporations are also subject to incorporation fees of twenty cents per $1,000 authorized capital stock (with a minimum of $25), and consolidation and merger corporations pay twenty cents per $1,000 authorized capital stock beyond the capital of the corporation consolidated (with a minimum of $20). Fees are also charged for extension of corporate existence, dissolution and increase. Foreign corporations pay a $10 privilege tax, except foreign insurance companies which pay $20. The state derives over sixty per cent of its revenues (exclusive of the railroad taxes apportioned to the counties for schools) from corporate taxes and fees. The state's only important special tax in addition to those on corporations is the inheritance

tax—a collateral tax of five per cent on estates over $500, and a direct tax, first levied in 1914, of from one to four per cent, with a $5,000 exemption.[1]

The localities rely mainly on the general property tax. The counties obtained 78 per cent and other local divisions 50 per cent of their revenues from this source in 1913.[2] Municipalities have in addition a $1 poll tax on all males over twenty-one years and a gross earnings tax of two per cent on public service corporations, excepting street railways, which pay five per cent. These are assessed by the state board of taxes and assessment and the tax is in addition to the general property tax. There is also, since 1914, a tax of three-fourths of one per cent on the capital, surplus and undivided profits of banks and trust companies.

2. EFFECTS OF SEPARATION

Owing to New Jersey's use of the general property tax for state purposes during only a brief and abnormal period it is impossible to compare conditions under the general property tax with conditions under separation; but the tendency toward extravagance, the equitableness of the present system, the extent of centralization of administration, and the relation of revenues to expenditures, may be shown absolutely, if not relatively.

Considering first the local systems, the only danger of extravagance or misuse of revenue which can be attributed to separation is at the time of the change. If the pressure of the general property tax will prevent unnecessary state expenditure then it will prevent to an even greater degree excessive local expenditure; for the general property tax, even where it is freely used by the state, furnishes a larger proportion of local than of state revenue. Only when the re-

[1] *Annual Report of the Comptroller of the Treasury*, 1915, p. xii.

[2] Computed from data in *Wealth, Debt and Taxation*, vol. ii.

moval of the state tax causes a considerable reduction of the tax rate will the local officials be able to make any large increase in the local rate and obtain without protest revenues for wasteful purposes. There is no indication that local officials attempted to take advantage of the slight reduction in rate occasioned by the removal of the state tax. Considering county taxes alone they rose nineteen per cent in the two years, 1880 to 1882, before the change, four per cent between 1882 and 1884, when the change was made, and sixteen per cent afterward, between 1884 and 1886.[1] This shows no undue increase.

As for equitableness New Jersey suffers like every other state employing the general property tax, whether for local or for state purposes, from unequal assessments. The valuation of public utilities, except railroads, for the general property tax is left to the local assessors. More than this, the pay of assessors is not sufficient to attract competent men; there are few uniform rules to guide them in their work; and local election or appointment subjects them to local pressure.[2] Further there is little attempt to classify personalty. It is all taxed under the general property tax. The inevitable consequences are undervaluation of public utilities through lack of proper information; undervaluation or total evasion of personalty, particularly intangibles, for the same and other causes; and undervaluation of manufactures through fear of competition from neighboring states. This means the relative overburdening of real estate, particularly that of private individuals. But real estate is not only overburdened; it is unequally overburdened. Assessed values within a single county in some cases vary from forty to eighty per cent of true value, and there are equal variations between different classes of property and even be-

[1] Computed from data in *Reports of the Comptroller*, 1880-1886.

[2] *Cf.* discussion in Mathews, *op. cit.*, pp. 727-737.

tween separate properties of the same class within each district.[1] Yet assessed values, though far from equal, compare very favorably with assessed values in other states. According to the census estimate for 1913 the ratio of assessed to true value of real estate was fifty-four per cent,[2] but it is believed by state officials and others acquainted with conditions in New Jersey that this ratio is seventy per cent or higher.[3] To what extent this is due to efficient administration, and to what extent separation is responsible, can not be determined, but separation, by doing away with one of the motives for undervaluation is perhaps a contributing cause.

Only to a limited extent does separation remove the causes of inequalities or the inequalities themselves, as far as the general property tax is concerned, but through the use of special taxes, which separation requires, certain classes of property are much more effectively reached and the burden on unclassified property subject to the general property tax is lightened. Further classification for local purposes, perhaps with certain exemptions, and more efficient and more centralized administration, will go far toward equalizing local taxes.

New Jersey has already attempted some centralization of administration. By acts of 1846, 1873 and 1883 county officials were granted powers of equalization within their counties, but with little effect. To cite one example, Hudson County, after having benefited for nearly twenty years from the services of a county board of equalization showed assessments in 1890 ranging from thirty-three to eighty per cent of true value.[4] In 1906 all existing county

[1] Report of *Commission to Investigate Tax Assessment in . . . New Jersey*, 1912, p. 16 *et seq.*

[2] *Wealth, Debt and Taxation*, vol. i, p. 16.

[3] This is the view of Mr. A. C. Pleydell of the New York Tax Reform Association.

[4] Mathews, *op. cit.*, p. 729 *et seq.*

TABLE V[1]

GROWTH OF ASSESSED VALUES

Date	*Taxable Values*	*Percentage Increase*
1895	$786,998,100	
1900	891,237,300	13
1905	1,153,683,000	29
1910	2,045,898,200	78

boards of equalization were abolished, and new boards, appointed by and responsible to the governor, were created, with the result that assessed values rose enormously. Equalization was not made a state matter until 1891, when, following the recommendations of a special commission of 1890, a state board of taxation was created. This board was not very effective at first, since it was given no power of raising valuations, but this was remedied in 1894 and the board was granted really more powers than it had the time to use.[2] It was superseded by a state board of equalization in 1906 with more members and larger powers, including that of removing local assessors guilty of wilful negligence. The board has not in practice been able to enforce this last power, since "wilful negligence" is difficult to prove.[3] It has, however, larger powers than are generally granted to central boards, and is using them very effectively.[4] This shows that centralization, which is generally conceded to be highly desirable, is entirely compatible with separation, and has not, in this case at least, been discouraged by lack of immediate state interest. The state school tax, since nine-tenths of it is apportioned to the counties on the basis of what the counties have contributed, and only one-tenth on the basis of children

[1] Compiled from *Reports of the New Jersey State Board of Equalization*, 1890-1910.

[2] Mathews, *op. cit.*, p. 733.

[3] *Ibid.*, p. 735.

[4] Since merging with the state board of assessors, 1915, this board is known as the state board of taxes and assessment.

of school age, can hardly be held responsible for the state's efforts to centralize and equalize local systems. There are still gross inequalities. Neither separation nor centralization has as yet completely eliminated these; but centralization has done away with a great many of them, and doubtless will abolish many more, though probably some will remain as long as the localities retain a system which has the general property tax for its central tax.

The local districts have had no difficulty in obtaining sufficient revenues, for very little property has been removed from local taxation. Only the "main stem," tangible personalty and franchise of railroads and canal companies, and the franchise of certain other corporations are reserved exclusively for state taxation, and a large share of the revenues from these are returned to the localities for the support of schools. In consequence the local divisions do not suffer.

The state system seems to be equally satisfactory. There is no complaint of extravagance. Expenditures are much the same as in similar states. Per capita governmental cost payments in 1913 amounted to $2.58 in New Jersey as compared with $2.55 for the Middle Atlantic States, and $2.30 for all.[1] The corporations are not heavily taxed, and the debt is very small, and is exceeded each year by the cash balance. The taxation of corporations is based on the assumption that there is a value over and above the value of the tangible property, which is not reached under the general property tax. To reach this franchise various forms of taxation have been introduced; but whether the tax takes the form of a gross earnings, gross premiums, or capital stock tax it can in no case, except where net earnings are less than twenty per cent of gross, and the rate of the tax is five per cent, exceed 1.2 mills on total valuation of the cor-

[1] *Wealth, Debt and Taxation*, 1913, vol. ii, p. 40.

poration,—assuming the average rate of return on capital to be six per cent. This would not be a serious additional burden even were the corporations taxed locally to their full value; and in consideration of the fact that the localities do not tax the full value of tangible property it is safe to say that the corporations as compared with real estate, are undertaxed rather than overtaxed. All railroad and canal property which is not locally taxed is taxed by the state at the same rate as property taxed locally, and consequently pays somewhat more than other corporations, and probably somewhat more than property in general, since the property assessed by the state is presumably assessed nearer true value. There is little equality between the different classs of corporations. Mining and manufacturing companies are exempt from state taxation, and of those corporations subject to the capital stock franchise tax the larger ones pay less owing to the regressive rate. Insurance companies paying on gross premiums pay at varying rates. Street railways pay five per cent on gross earnings to the local tax districts, and other public utilities, except railroads, two per cent.

Centralization of administration has been adequately considered under the local system.[1] It need only be added that the state board of equalization and state board of assessors were merged in 1915 in order to secure further equality, as well as efficiency and economy. This and other minor changes mark a growing centralization of administration.

The revenues of the state have proved ample, contrary to the experience of most states that have attempted separation. This is due to the fact that New Jersey is the home of much of the wealth employed in New York; for a large number of corporations which operate for the most part in New York have obtained their charters in New Jersey. Twenty-five per cent of all state receipts and seventy-nine per cent

[1] *Supra*, p. 98 *et seq.*

of the revenues of the state fund were derived from corporations in 1913.[1] The result has been that the state has for more than thirty years enjoyed a surplus. But a surplus of any size has generally been found to encourage unnecessary expenditures. The state has no tax which it can adjust to needs. The railroad tax has, since 1906, been made equal to the average rate on other property locally taxed, but the state has returned all above the one-half per cent previously obtained, to the localities for schools. But even were the state to keep the tax there would be no necessary relation between the changes in local needs and the changes in state needs. All other taxes are at fixed rates. The state has, through subventions, turned over a large amount of its revenues to the localities, giving them, since 1897, in addition to the proceeds of the school tax, the entire yield from certain railroad property, and, since 1906, part of the yield from all railroad property. Even so a cash surplus has accumulated and there has been no debt, as in Pennsylvania, to absorb it. The surplus of the sinking fund exceeded the debt from 1898 until 1902. The sinking fund was abolished in this year, but the small debt which still continued has been more than covered by the cash and securities [2] of the state.

The state apparently has not suffered from this surplus. In 1881, three years before the passage of the important corporation tax laws, revenues were found sufficient to omit the state tax—but only for one year. Increasing appropriations of the legislature made it necessary to return to it the next year, and after its omission in 1883, even with the new corporation taxes. the comptroller complained of the extravagant appropriations of the legislature and

[1] *Report of the Treasurer*, 1913.

[2] *Wealth, Debt and Taxation*, 1913, vol. i, pp. 166-167.

insufficiency of revenues, and it was found necessary for some years to borrow to meet current expenditure. The growth of the new sources, however, soon made revenues ample. The floating debt was cancelled in 1891 and a considerable surplus was realized each year thereafter.[1] Rising expenditure, principally for new buildings, led the comptroller to give warning, in 1896, that if such expenditure continued it would be necessary to levy a state tax again. But retrenchment followed, and in 1898 the comptroller declared the financial condition of New Jersey to be more satisfactory than that of any other state.[2] The surplus continued to rise until 1903, when increasing appropriations for new buildings, for increased expenses of institutions, and to counties for schools again reduced it, and in 1907 the comptroller once more was forced to remind the legislature that such appropriations would necessitate a state tax.[3] Again appropriations were reduced and the surplus rose in response. There is no indication in this of any gross extravagance or misuse of funds, although it may be that there was no great demand for many of the public buildings erected. The custom of increasing appropriations to counties for schools has done much to reduce the surplus. But the action of the legislature suggests throughout an effort to accommodate expenditures to revenues. It can hardly be hoped to secure even a crude adjustment of revenues to expenditures without an elastic tax. To adjust expenditures to revenues is likely to lead to extravagance in case the revenues are large, or to failure to make needed expenditures in case revenues are small, although it is conceivable that a state might spend a growing income to good advantage. If, on the other hand, no adjustment is made, a deficit or a surplus is inevitable.

[1] *Report of the Comptroller*, 1891.

[2] *Ibid.*, 1898, p. 7.

[3] *Ibid.*, 1907, p. 2.

CHAPTER VII

Partial Separation in Vermont

I. HISTORY OF TAXATION IN VERMONT

Vermont, in common with the other New England states, employed the general property tax as the principal state tax for nearly a century. This source of revenue began to decline in importance after the Civil War, but was not given up entirely for state use until 1902. It is still employed by the state for school and highway purposes, but the yield is returned to the local districts—although not in proportion to assessed value. As in other states where the general property tax has been abolished for state purposes the state reserves the right to levy a direct tax at any time, and such a tax was actually levied in 1914, and again in 1916.

TABLE VI

General Property Tax in Vermont, 1870–1916[1]

Year	*General Revenue*	*General Property Tax*	*Percentage of Revenues from Property Tax*
1870........	$562,621	$515,410	91
1880........	477,688	384,734	81
1890........	692,257	353,412	51*
1900........	938,490	346,811	37*
1910........	1,230,644	......	..
1914........	2,114,567	241,225	11*
1916........	2,953,704	......	..

* This tax was levied only every other year after 1884. Consequently it did not play such an important role as these percentages indicate.

[1] Compiled from *Reports of the Auditor of Accounts of Vermont* for these dates.

Early general property taxes were levied on a grand list, which was at first made up of different classes of property listed at various percentages of actual value according to kind and value.[1] Unimproved land and some buildings were exempt.[2] In 1841 these classes and exemptions were abolished and all property was placed on the grand list at one per cent of its estimated true value. Thus the general property tax was made an equal tax on all classes of property.[3] No other important changes were made in the tax although its administration was the cause of considerable legislation. Immediately following the law of 1819, which first put the assessment of real estate on the basis of actual value, inequalities led to the establishment of both county and state boards of equalization.[4] This was followed by a number of acts aiming to reach personalty more successfully and to equalize the assessment of real estate, but the tax was not sufficiently burdensome to cause serious complaint until after the Civil War, for Vermont never became involved in the policy of state aid to railroads and canals which brought many of her neighbors into such serious financial straits. Beginning about 1870, however, increasing complaints aroused investigation and reform.[5] Low and unequal rates of assessment were found; personalty was rapidly disappearing from the lists, and what remained was assessed at even lower and more varied rates than real estate. The state and county boards of equalization, while preventing some of the more glaring inequalities, were un-

[1] Carriages, for instance, were listed at 12 per cent, cash at 6 per cent and dwelling houses valued at less than $1,000 at 2 per cent, those over that being 3 per cent. (F. A. Wood, "Finances of Vermont," *Columbia University Studies in History, Economics and Public Law*, 1912, vol. lii, no. 3, p. 32.)

[2] *Ibid.*, p. 30.

[3] *Ibid.*, p. 38.

[4] *Ibid.*, p. 34.

[5] *Ibid.*, p. 101 *et seq.*

able, and in some cases unwilling, to accomplish any real equality.[1] To remedy matters, listers were invested with greater powers, and penalties for failure to enforce the law were made more severe; but the growth of corporation taxes, and the consequent decrease in the state tax on general property, relieved the situation before any important steps had been taken to secure greater equality. In 1882 state equalization was given up entirely.[2]

The appearance of special taxes not levied on the grand list [3] began with bank taxation in 1818. The tax was determined for each bank as incorporated, and was generally on profits, although in some instances it was placed on capital value.[4] These taxes did not take the place of the tax on shareholders and soon disappeared. After 1854 the tax on shares of non-residents only was paid by the banks to the state.[5] This was distributed among the counties.

Similar taxes were applied to the profits of domestic fire-insurance companies in 1829. Foreign fire-insurance companies had, since 1825, been taxed on gross premiums collected within the state. Various acts followed, including, in 1854, a retaliatory law.[6] These were the only efforts made to reach corporations before 1878. Most of the laws were soon abandoned and apparently none of them ever were seriously enforced or were productive of much revenue.

In 1878 banks were again chosen for special taxation. This time savings banks were taxed on deposits and accu-

[1] Wood, *op. cit.*, p. 101. [2] *Ibid.*, p. 103.

[3] Poll taxes have always been an appreciable source of revenue, and income taxes were levied until 1850,—but these were levied on valuations placed on the grand list with property.

[4] The rates on profits varied from 6 to 12 per cent; those on capital value from one-third to one-half of one per cent.

[5] Wood, *op. cit.*, p. 45 *et seq.* [6] *Ibid.*, p. 47.

mulations. This tax, except that part of it levied on deposits owned by non-residents, was returned to the towns. It was revised in 1882, being made a strictly state tax, and applying only to deposits under $1,500. Deposits in excess of this amount were taxed by the towns to the individual owners. Trust companies were taxed in the same manner.[1] These taxes did not take the place of local taxes on shares. Various changes in rates and exemptions followed. At present both savings banks and trust companies are taxed seven-tenths of one per cent on all deposits regardless of size and without deductions for real estate. Such deposits are exempt from local taxation. National banks have been taxed in the same manner since 1906 on all deposits bearing over two per cent interest. The tax is optional, the bank being privileged to leave such deposits under the general property tax.[2]

The year 1882 marked the real beginning of the present system of corporation taxation. Insurance companies, domestic and foreign, were, beginning in this year, taxed two per cent on premiums and assessments received within the state, with a retaliatory measure added in 1888. Domestic life-insurance companies were in addition taxed one-half of one per cent on surplus over four per cent of policies less the value of real estate. This tax was raised to one per cent in 1890, and in 1908 was applied also to domestic fire, accident and fidelity companies.[3]

Railroads were taxed on gross earnings under the law of 1882.[4] Though subject to certain specific provisions previous to this time, they had remained under the general property tax. In 1890, following a decision of the Vermont supreme court declaring this provision of the law

[1] Wood, *op. cit.*, p. 81 *et seq.*

[2] *Ibid.*, p. 84.

[3] *Ibid.*, pp. 85-86.

[4] *Ibid.*, p. 86 *et seq.*

unconstitutional, a tax of seven-tenths of one per cent on valuation was imposed instead, with an optional tax on gross earnings of 2.5 per cent. The latter was generally chosen. These rates were raised in 1904, 1906 and 1908, as the result of a report in 1900 which showed real estate to be paying four times what railroad property was paying.[1] At present railroads pay a tax on valuation at the rate of 1.25 per cent. The optional gross receipts tax was repealed in 1912.[2]

Express, telegraph, telephone, steamboat, car and transportation companies were also brought under the gross earnings tax of 1882.[3] All of these companies, except express and telegraph companies, which had been taxed on gross earnings since 1880, had been under the general property tax up to this time. In 1890 the tax on steamboat, car and transportation companies was changed to one on valuation, with an optional tax on gross earnings. The rates of these taxes are at present one per cent on valuation and 2.5 per cent on gross earnings. Express companies remained under the gross earnings tax until 1906, when a flat rate of $8 per mile of road over which their business was carried on was substituted. This was later raised to $20, and in 1915 reduced to $16. Telegraph companies remained under the gross earnings tax until the law was contested in 1892. Then, to obviate difficulties, the legislature made the tax one of sixty cents per mile of one-line wire and forty cents for each additional mile of wire, with the alternative of a three per cent tax on gross earnings received within the state. This remains today. No change in tele-

[1] *Double Taxation in Vermont. Report ... to the Legislature of 1900*, p. 38.

[2] *Report of the Commissioner of Taxes*, 1914, p. 4 *et seq.*

[3] Wood, *op. cit.*, p. 92.

phone company taxation was made until 1902, when the gross earnings tax was replaced by one on transmitters and miles of wire. In 1904 the alternative of a gross earnings tax was offered.[1] Both of these taxes were abolished in 1914 and a tax of 1.25 per cent on actual value was imposed.[2] The gross earnings tax on sleeping-car companies was replaced in 1904 by one of seven-tenths of one per cent on valuation, and parlor and dining car companies were included.

Thus at present express companies pay a flat rate; railroad, telephone, sleeping car and dining and parlor car companies pay on valuation, and other transportation companies, including telegraph companies, have as an alternative, which is generally taken advantage of, a gross earnings tax.

Insurance companies are taxed on gross premiums, and bank and trust companies on deposits, with the alternative of the general property tax. No attempt has been made to reach the other classes of corporations except under the general property tax, and manufacturing and mining companies may be specifically exempted from that tax for a period of ten years.

Graduated incorporation taxes have been levied since 1898, and annual license taxes on all corporations, domestic and foreign, of from $10 to $50 have also been levied since 1898.[3]

The preponderance of the agricultural element in the legislature where the corporations are not adequately represented accounts for the popularity of corporation taxes. The state derives by far the larger part of its revenues from these sources. The only other important revenues

[1] Wood, *op. cit.*, p. 95.

[2] *Report of the Commissioner of Taxes*, 1914, p. 19 *et seq.*

[3] Wood, *op. cit.*, p. 96.

are from licenses and a five per cent collateral inheritance tax, introduced in 1896.

TABLE VII[1]

SOURCES OF STATE REVENUE, EXCLUSIVE OF LOANS, VERMONT, 1916

Source	*Amount*	*Per cent of Total*
Total	$2,953,704	100
Corporation	1,582,077	53.5
General Property	316,104	10.7
Inheritance	101,593	3.5
Miscellaneous	953,930	32.3

REVENUES FROM CORPORATION TAXES, 1916

Total	$1,582,077	100
Banks and Trust Companies	755,762	47.8
Railroads	549,380	34.8
Express, Telegraph and Transportation	26,054	1.6
Telephone	44,356	2.8
Insurance	174,661	11.0
Annual License Tax	31,584	2.0
Annual Charter Tax	280	0.0*

* Less than one-tenth of one per cent.

The grand list tax, which has always been of the nature of a general property tax, and since 1841 has been distinctly such a tax, is the backbone of the local fiscal system. It supplied 71 per cent of revenues in 1914.[2] Licenses, receipts from public lands, and subventions, however, have been at various periods of considerable importance. Subventions consist principally of the proceeds of educational and highway funds and of the state school and highway taxes, and are devoted to these specific purposes. The school tax of five mills (now eight mills) was first levied in 1890 and the highway tax of five mills in 1892.[3] They are apportioned in part according to the number of schools and miles

[1] Compiled from the *Report of the Commissioner of Taxes* and *Report of the Treasurer*, 1916.

[2] Computed from data in *Report of the Treasurer*, 1914.

[3] Wood, *op. cit.*, p. 115 *et seq.*

of road, in part according to local expenditures for these purposes, thus obtaining a redistribution which favors the rural districts at the expense of the urban districts. These taxes are the result of Vermont's system of representation in the state legislature which gives the rural districts a disproportionate share of seats in the legislature, but if official reports may be trusted they are highly satisfactory.

2. EFFECTS OF SEPARATION

Separation has arisen in Vermont largely as a result of the peculiar system of representation just referred to. The agricultural interests have been eager to shift the burden of taxation as far as possible to the corporations, and they have been in a position to do so. The amount of corporate wealth in the state is not large, but the corporations have borne the weight of the state expenditures without serious inconvenience.

Separation, owing to the levy of the school and highway taxes, has never been complete. These taxes are levied in proportion to assessed value, but, unlike New Jersey, are distributed entirely according to other standards, and consequently leave the same incentive for the localities to under-assess property as exists under a tax for state purposes. Nevertheless, most of the effects of separation have been realized, for the tax is small, and in any case the removal of the state tax seems to have little effect on local assessments. Further, the tax is for purposes which are—or have been until recently — ordinarily considered local. Revenue for strictly state purposes is entirely separate and, to the extent that corporation taxes are depended on, separation of source is complete, since the property of these corporations is reserved exclusively for state taxation. What is generally held to be the chief gain of separation—the removal of the state general property tax—has been realized; and likewise the chief defect—inelasticity of revenues.

There is no suggestion that separation has encouraged extravagance on the part of the localities. As already explained, such extravagance, if it occurred, would be only an immediate and temporary result. The declining need of revenues resulting from the relief from war expenditures,[1] and the rapidly rising value of taxable property during the period of growing separation, and the rising expenditure—due to increased governmental activities in the later period of achieved separation—are not peculiar to Vermont. Similar changes are reflected in the tax rates of other states. The sharp decline in the rate on general property from 1880 to 1902 is due only in part to the reduction of the state tax, since this tax never rose above fifty cents in the decade preceding 1880, and still averaged nearly ten cents annually (though levied only once in two years) in the twenty years following. Whether or not local officials took advantage of the decline in rate cannot be determined from the tax rates. There appears to be no specific complaint of extravagance.

The rate of assessed to actual value of real estate in 1912 was seventy per cent according to federal census estimates. This is comparatively high, being exceeded by only nine states. There is little complaint of inequalities. That inequalities exist, here, as elsewhere, has been noted.[2] The usual complaints of undervaluation of real estate and total evasion of personalty are made; the usual causes—incompetence or dishonesty of assessors and the difficulties of reaching intangibles under the most favorable circumstances—are assigned; and the usual remedies—centralization of administration and low rate taxes on intangibles—are suggested. Yet inequalities are not as serious as in many states. An

[1] *Cf.* Wood, *op. cit.*, p. 79 *et seq.*

[2] See Commissioner of Taxes, *Special Report Relating to Taxation*, 1902, pp. 46-47; *Report of Commission on Taxation, Vermont*, 1908, p. 20.

investigation made in 1900 revealed the fact that the lowest rate of appraisal in towns was 66.7 per cent and that the average rate of assessment in counties was from 78 to 96 per cent.[1] Some slight changes have been made, but if the average rate of assessment of real estate was 70 per cent in 1912, as compared with 71.7 per cent in 1900 (as given in the federal census),[2] apparently neither separation nor improved administration has proved effective. The real grievance of the bearer of the general property tax is, however, the large number and the inequalities of the exemptions. Personal property exempted on account of deductions for indebtedness alone amounted, in 1902, to 65 per cent of all personalty listed; in 1910 it was equal to 72 per cent.[3] No provision was made for deduction for debts on real estate, but recently (1915), to avoid double taxation, mortgages have been exempted.[4] Attempts to abolish many exemptions and secure a low-rate tax on intangibles have been unsuccessful. Exemptions are not, perhaps, as serious a matter as they are usually asserted to be, since the property exempted is in large part the property of corporations taxed by the state, and intangibles, which usually escape anyhow under the general property tax; but the tax rate of $1.81 (1912), while not high, measured according to assessed valuation,[5] is high when the rate of assessed to true value is considered. It means a rate of approximately 13 mills (or more since real estate bears a much larger proportion of the tax than personalty) on actual value.[6] It is also high com-

[1] *Report on Double Taxation*, p. 35.

[2] *Wealth, Debt and Taxation*, 1913, vol. i, p. 16.

[3] Wood, *op. cit.*, p. 107.

[4] *Report of Commissioner of Taxes*, 1916, pp. 16-17.

[5] The rate on assessed valuation was exceeded in 1912 by thirty states. *Wealth, Debt and Taxation*, 1913, vol. i, p. 751.

[6] *Cf.* Pennsylvania with a rate of 11 mills (1912), Michigan, 12 mills (1911), Wisconsin, 13 mills (1913), and New York, 17 mills (1914). These states are all industrially far in advance of Vermont.

pared with the taxes on corporations. Those corporations subject to the *ad valorem* taxes, assuming their assessed valuations to be equal to real, pay from seventy cents to $1.25 (*cf.* real estate with a tax rate on real value of $1.27). Those subject to gross earnings taxes pay less. Thus real estate, except that classed as operative property of corporations, is paying more than other property in the state. Separation has not resulted in a light burden on such property, although the revenue for state purposes — and per capita state expenditures are relatively high in Vermont—is derived entirely from other sources. The explanation is that Vermont, like California and Connecticut, has deprived the localities of the privilege of taxing the property of those corporations which are taxed by the state. Also, as has been mentioned above, there are a large number of exemptions, some of which perhaps are not justifiable. This has resulted in concentrating the burden of relatively small taxes [1] on a small amount of property. On the one hand, separation has removed the burden of the state tax from general property; on the other it has narrowed the base for the local tax. To measure the gain or loss to the owner of real estate is practically impossible; but while the gain or loss must vary from district to district and from property to property, it is almost certain that, taking the state as a whole, real estate, particularly that in rural districts, where there has been less corporate property to exempt, is paying less than it would pay under a general property tax for state and local purposes. Special corporation taxes centrally administered, even when low and permitting many exemptions, reach corporations far more effectively than the general tax; and the more corporate property pays the less is borne by other property.

[1] In 1913 only three states, Alabama, New Mexico, and North Carolina, collected smaller local revenues per capita than Vermont. (Estimated from data in *Wealth, Debt and Taxation*, 1913, vol. ii.)

The first effect on the administration of the general property tax of the effort to separate revenues was a step toward decentralization; for while the state undertook central valuation of corporate property for state purposes, it gave up (1882) the function hitherto exercised of equalizing local assessments—the assumption being that the removal of the state tax would remove the causes of inequalities, and that the greater powers and penalties given the listers at the same time would be sufficient to cope with the situation. When it was realized that greater equality had not been obtained, agitation for state control again arose. An investigation made in 1908 showed the existing administrative provisions to be both inadequate and unenforced, and in consequence the commissioner of taxes was given enlarged powers in 1910 which permit him to instruct local listers and require them to make any returns he may desire.[1] Effective central control has not yet been attained, but the tendency is decidedly in that direction. Separation does not do away with the need of such centralization, nor does it prevent it—although in the case of Vermont it has apparently retarded it.

Local divisions have obtained revenue without difficulty. The withdrawal of corporate property from local taxation has been gradual and in consequence readjustment has not been difficult. Further, the control of the distribution of school and highway taxes by the state has relieved the poorer districts. The burden on realty is heavy and local expenditure is rising rapidly; but the localities do not appear to be suffering seriously and the agitation for a low-rate tax on intangibles and the abolition of many of the present exemptions may at any time result in legislation which will relieve real estate.

[1] Wood, *op. cit.*, p. 110.

The reports of the state officials are singularly noncommittal as to the working of the present system and the activities of the state legislaure, offering no praise and making no complaint. The financial condition of the state appears, however, to be very good. Receipts are generally slightly in excess of disbursements, and the small funded and floating debt is easily covered by the cash and securities of the state, and in some years by the cash balance alone.[1] Expenditures have increased steadily and rapidly since 1880 (increasing four fold in the thirty years 1880-1910,[2] and 65 per cent in the three years 1910-1913),[3] but they have readily been met. The general property tax was levied once in two years until 1902, but after that date it was found unnecessary until 1914, when a tax of one mill was again levied. During this period there is no evidence of extravagance. The rise in expenditure is due to the increased activities of the government, such as have been undertaken in recent years in all of the states—those employing the general property tax as well as those depending on corporation taxes. Per capita state expenditure is (1913) $6.54,[4] which is higher than that of any other New England state except Massachusetts. This can be accounted for by the very heavy expenditure incurred for education and the very considerable outlay for highways. In addition, the state support of charitable, correctional and penal institutions is generous, and a large number of commissions are maintained. Such expenditure is going on throughout the country—and if in Vermont it is higher than in most states, at least there has been no complaint, and it has not resulted in a heavy burden on the corporations, which are paying

[1] *Wealth, Debt and Taxation*, 1913, vol. i, pp. 208-209.

[2] Computed from data in Wood, *op. cit.*, pp. 140-141.

[3] Computed from data in *Treasurer's Reports* for these years.

[4] *Wealth, Debt and Taxation*, 1913, vol. ii, p. 40.

less than property locally taxed and no more than corporations in most of the states where they are subject to special taxes.

As for the equitableness of the state taxes, the central valuation of corporate property has been fairly successful, so that inequalities between the corporations of one class are small. No great effort has been made to obtain equality of the burden borne by different classes of corporations—which is of less importance. Railroad and telephone companies pay $1.25 per $100 valuation, and car companies and banks (on deposits) pay seventy cents. Insurance companies pay from one to two per cent on premiums. Telegraph companies pay three per cent on gross earnings, which is probably less than other corporations are paying, though with no data on the ratio of gross earnings to actual value no exact comparison can be made. Manufacturing and mining companies, which are taxed under the general property tax with a ten-year exemption, probably pay least of all, owing to ineffective local assessments. Those corporations paying $1.25 on valuation, while paying nominally less than the general property tax rate, are, if assessed at true value, paying nearly as much as other property—$1.25 as compared with $1.27 on actual value in 1912. The tendency to increase the rates on corporations leads to greater uniformity as well as to greater revenues. Though uniformity in the treatment of different and non-competing classes of corporations is not of vital importance, and may not even be desirable in some cases, such uniformity is unquestionably better than haphazard differentiation which is not based on any fiscal principle.

The administration of state finances has been centralized through separation. All assessments for state taxes are under the direct control of a commissioner of taxes who, with a few minor exceptions, has powers adequate to fulfil

his duties. Unfortunately his supervision does not extend to the valuation of corporate or other property taxed locally, though there is at present a tendency to extend his powers to this field.

The revenues of the state have been kept a little in advance of expenditures by means of frequent revision and increase in the rates of corporation taxes, but the growth of expenditures has absorbed increasing revenues very rapidly, and in the year 1914 it was found necessary to levy a small direct tax to meet a deficit incurred during the year preceding. There is no expectation of permanent utilization of this source, however. The natural development of corporate wealth will afford some increase, and manufacturing and mercantile corporations, as well as some public utilities, are still untouched by the state. To remove these from local taxation would at present cause some hardship, even though the localities reach them most ineffectively, but a low-rate tax on intangibles and the removal of some of the present exemptions might be offered as compensation. Further the introduction of a direct inheritance tax and the application of progression to the collateral inheritance tax would doubtless create a lucrative source of revenue. Finally, an income tax (which has been seriously recommended) could be made an unlimited source.

The state has no appreciable debt and no stringency of funds has yet been felt; but expenditures have followed revenues so closely that it seems probable that unless the general property tax is going to be resorted to freely, as needed, some decisive action will have to be taken in a few years.

CHAPTER VIII

Partial Separation in West Virginia

I. HISTORY OF TAXATION IN WEST VIRGINIA

West Virginia has in her constitution the provision, which she has tried in vain to abolish, that "taxation shall be equal and uniform throughout the state, and all property, both real and personal, shall be taxed in proportion to its value."[1] Owing to this, West Virginia has never been able to employ special corporation taxes; but the state has succeeded in obtaining large revenues from an inheritance tax, licenses, and franchise taxes (for which last provision was specifically made in the constitution in 1872).[1] The income from these sources is almost sufficient for state needs. As a result the state general property tax, except for school purposes, has been reduced until it yields a comparatively small revenue. This is the only instance of a state attempting, with fair success, to separate revenues without classifying property for taxation.

The fiscal system of West Virginia is based on the general property tax and licenses,—the usual form in the southern states. At the time that West Virginia was created as a separate state, in 1863, the Virginia system was continued, with the general property tax for the central tax of the state and of the local systems. The amount of state revenue which this tax yielded grew steadily until 1905, but the proportion of total state revenues from this source has gradually declined since 1875; for while the state direct tax increased but little more than one hundred per cent during

[1] *Constitution*, article x, sec. 1.

these thirty years the total receipts increased nearly five hundred per cent.

TABLE VIII[1]

STATE GENERAL PROPERTY TAX IN WEST VIRGINIA, 1875–1915

Year	*Receipts of State Fund*	*Amount of State General Property Tax*	*Percentage of State Fund Yielded by Property Tax*
1875	$324,195	$244,926	79
1885	568,785	262,177	46
1895	1,135,694	375,644	33
1905	2,352,317*	580,994	25
1915	6,134,897	1,222,000†	20

* After 1904 the state fund included certain revenues from license taxes and later from the general property tax which are transferred to the school fund and some from public service corporations which are refunded to the local districts.

† According to the State Tax Commissioner (*Second Annual Report of the State Tax Commissioner*, 1915–1916, p. 23) this tax will be used in the immediate future only for the cost of permanent improvements to state buildings and institutions. This will reduce it materially. However, if West Virginia should be forced to assume her share of Virginia's debt which seems probable at the present writing, the state tax might again be resorted to for large revenues.

The general property tax early met with the criticism that was being accorded to it in all parts of the country. A special tax commission, reporting in 1884,[2] estimated that the amount of intangible property evading taxation was $50,000,000, and that the ratio of assessed value to selling price in the different counties varied from 19 to 226 per cent.[3] This commission also called attention to the difficulties of collecting taxes, particularly those of the railroads. Although these were subject to a certain amount of state supervision, having been assessed by the board of public works, and having been required to pay taxes to the state treasurer,

[1] Compiled from data in *Biennial Reports of the Auditor of West Virginia*, 1875-1915.

[2] *Preliminary Report of the West Virginia State Tax Commission*, 1884.

[3] *Ibid.*, p. 8.

since 1869, the auditor and county sheriffs were unable to collect delinquencies. In 1870 only one-third of the taxes due were collected.[1] These difficulties led the counties to compromise with the railroads for the amounts due them. This and the evasion of personalty resulted in throwing an increased burden on real estate, until in 1884 it was paying 65 per cent of all taxes.[2] New taxes on corporation charters (1885), and on collateral inheritances (1887), were imposed following this report; but no great effort was made to improve administration. Probably the burden of taxation did not weigh sufficiently heavily.

The rate on assessed value during this time was high, but this was due to the low rate of assessment. It has been estimated[3] that realty and tangible personalty were taxed at this period at from 10 to 60 per cent of actual value. In consequence this high rate was not for the most part burdensome, although the inequalities were quite as serious here as in other states.

A second tax commission, in 1902, reported with more effect,[4] and in 1904 a special session of the legislature revised the entire system, with the aim of centralizing the administration of the state and local taxes and abolishing, or at least greatly reducing, the state direct tax,—replacing it with other taxes. To this end a number of measures were enacted. A state tax commissioner with some power of controlling local administration, was created; but in the absence of the power of appointment and removal his action was largely advisory. He was, however, given the power of appointing special assessors for an entire reassessment of real estate in 1905 at its "true and actual value," instead of

[1] *Preliminary Report of Tax Commission*, p. 40.

[2] *West Virginia, State Tax Commission*, *1884*, *Final Report*, p. 40.

[3] *Conference*, 1910, p. 168.

[4] *Ibid.*, pp. 167-168.

"fair cash value" as hitherto. He was further invested with the power of collecting the inheritance tax, which had up to that time been ineffectively administered by county officials. The assessment of all public-service corporations —instead of only railroads as before—was made a duty of the state board of public works. License taxes were revised, the state tax on general property was reduced to five cents per $100 valuation, and the limit on the rate of levy for local purposes was further reduced.[1] In 1906, and again in 1908, with the hope of raising valuations, the limits were put still lower.[2] The result of this legislation was, in the five years from 1904 to 1909, to increase the assessed value of real estate 3.43 times, to increase that of personalty 2.75 times, and that of public-utility property 8.75 times.[3] As a result of this the tax rate for all purposes was at the same time reduced from $2.15 to 85 cents. The combined state and state school taxes were 4.5 cents in 1910.[4] Most of the revenue thus collected was used for school expenditure,—less than $100,000 being used for state purposes. Thus the state has successfully reduced the tax on general property, and introduced—as far as the constitution will permit—other sources.

Gross receipts taxes were levied on express and insurance companies, beginning 1864, and telegraph companies, beginning in 1882.[5] The return from these taxes was, however, negligible, except from the tax on insurance companies, which since 1882 has risen rapidly. The gross receipts taxes

[1] *Conference*, 1910, pp. 169-170.

[2] The present maximum rates are 10 cents for state and state school purposes, 30 cents for county, 35 cents for municipal, and 15 cents, 25 cents, 10 cents and 5 cents, respectively, for various local school purposes. (*Wealth, Debt and Taxation*, vol. i, p. 101.)

[3] *Conference*, 1910, p. 171.

[4] *Ibid.*, p. 173.

[5] *Laws of West Virginia Relating to . . . Taxes*, 1887, ch. xxxiv, sec. 13.

on express and telegraph companies were abolished in 1901, and mileage taxes on foreign companies were established. These are in addition to the state and local property tax. In 1904 the taxation of all public utilities was brought under state control.[1]

License taxes, which were borrowed from the Virginia system, yielded more than three-quarters of a million dollars before 1914; but in that year prohibition was introduced, and since approximately four-fifths of the revenues from licenses had come from liquor licenses, this source is now of slight importance. An annual license tax on the charters of corporations, graded according to the amount of authorized capital stock, and differing for domestic and foreign corporations, was first imposed in 1885. It has developed into a lucrative source of revenue. The collateral inheritance tax law enacted in 1887 proved ineffective as long as it was under local administration; but with central administration, undertaken in 1904, the yield was greatly increased; and the revision of the law and the addition of a direct inheritance tax, in 1909, have made it one of the leading sources of revenue. The present rates are one to three per cent on direct inheritances with a $25,000 exemption,[2] and three to five per cent on collateral heirs with no exemption.[3]

Local revenues are derived mainly from the general property tax although poll taxes are an important source for school purposes.[4]

2. EFFECTS OF SEPARATION

West Virginia had the good fortune to start free at a period when other states were most deeply in debt. The

[1] *Conference*, 1910, p. 170.

[2] For the estate, not the individual bequest.

[3] *Conference*, 1910, p. 289.

Wealth, Debt and Taxation, 1913, vol. ii.

period of extensive borrowing for internal improvements and for the encouragement of private enterprise was over, and the Civil War was nearly ended. The third of Virginia's debt which was assigned to the new state she refused to assume. In consequence no appreciable debt has ever accumulated, and since 1895 the state has been totally free from debt.[1] This freedom from handicap has been the chief cause of West Virginia's prosperous financial condition, and has made the small general property tax possible without the imposition of heavy corporation taxes. The local governmental cost payments (including counties and all local districts of over 2500 population) were, in 1913, $18.50 per capita.[2] Only five states had lower costs per capita, and taking state and local payments together only two states, Alabama and New Mexico, paid out less than West Virginia. The local per capita general property tax was smaller in only seven states. These small revenues and expenditures are not, of course, solely due to early freedom from debt. The state has not extended its activities as rapidly as most of the neighboring states.

The per capita general property tax was, in 1912, $7.67.[3] Nine states had a lower per capita rate at this time. The average rate on assessed valuation was 86 cents per $100. This is lower than that of any other state, the next lowest being $1.02 (in Kansas). If assessed values are only 49.7 per cent of true value, this makes a tax rate on real value of 41.1 cents. No state has a smaller rate on actual value.

The burden of the general property tax has always been

[1] *Wealth, Debt and Taxation*, vol. i, pp. 216-217. In 1912 West Virginia was the only state without a debt, though in Pennsylvania the assets of the sinking fund exceeded the debt. (*Wealth, Debt and Taxation*, 1913, vol. i, *passim.*)

[2] From data in *Wealth, Debt and Taxation*, 1913, vol. ii.

[3] *Ibid.*

light, but the assessment has not always been accurate. The ratio of assessed value to actual value is still, according to the census report,[1] only 49.7 per cent (1912), but, beginning in 1904, the state has taken heroic measures to attain equality, and the increased limitations on the tax rates and the centralization of administration, have tended to equalize assessment ratios, and probably to raise them.[2]

Central control has been well developed. The state tax commissioner, appointed in 1904, collects the inheritance tax and some of the licenses. He also has general control of other taxes, although he acts chiefly in an advisory capacity, —meeting with the board of public works, offering suggestions and requiring reports from local financial officials, and requiring them to keep levies below the maximum limit. County assessors are still elected, and these value corporate property, other than that of public service corporations, as well as that of private individuals; but the assessments made by the state-appointed assessors in 1905 have at least given them a standard for their work for a time. All of the property of public service corporations is assessed by the board of public works, which is made up of state officials. There is no state board of equalization, but appeals from the county boards to the circuit court are provided for.[3]

This system has supplied the state with ample revenues. Not only has the state no debt, but, in 1912, the cash and securities of the state were in excess of two and a half

[1] *Wealth, Debt and Taxation*, 1913, vol. i, p. 16.

[2] The state tax commissioner, while quoting no definite ratios asserts that the ratio of assessed to true value has been raised decidedly. (*Conference*, 1910, p. 171; 1909, p. 347). He is further quoted by the commissioner of corporations (Bureau of Corporations, *Taxation of Corporations*, pt. vi, 1915, p. 69) as putting the ratio of assessed to actual value at 70 per cent. The increase of taxable values would seem to support this statement.

[3] *Conference*, 1910, p. 168.

million. The adoption of prohibition in 1914 is cutting down revenue,[1] and the state, although up to this time it has been somewhat backward in governmental activities, is now beginning to expand its functions. Even so there seems to be no immediate danger of shortage of revenues.

West Virginia is far from having abolished the state general property tax. The state derives only a very small portion of its revenues for strictly state purposes from the locally administered general property tax; but if the school tax—which is paid to the state and then distributed according to the number of children of school age in each district—is included, it amounts to fourteen per cent of total revenues. If, further, the tax on public service corporations is included,—and this tax is distinctly an *ad valorem* tax (differing from the tax on other property only in being centrally administered), the general property tax may be said to equal twenty per cent of the revenues of the state fund.[2] To this extent sources are not separated. However the other eighty per cent is quite separate; license taxes, the taxes on insurance companies, and the collateral inheritance tax are distinctly state taxes. West Virginia has been striving consciously to attain separation under the handicap of a constitutional provision preventing classification for taxation. If the state should succeed in removing this barrier, as it is trying to do, it seems probable that separation will be completed.

[1] By approximately $1,000,000: one quarter of a million for the localities and three quarters for the state.

[2] Exclusive of that part of the public-service corporation revenues returned to the localities. (Estimated from *Auditors' Reports.*)

CHAPTER IX

Separation in California

I. INTRODUCTION

California alone of those states achieving separation of revenues accomplished it at one move. In all of the other states the change was gradual. Special state taxes, particularly special corporation taxes, were experimented with first, when they were found to provide sufficient revenues for state use the general property tax was gradually reduced, and finally omitted altogether.

The constitution of California, after its revision in 1879, did not, as did many state constitutions, require that taxation be "equal and uniform," but it did provide that "*all* property in the State . . . shall be taxed in *proportion* to its *value*."[1] This was interpreted to mean the same thing, and so prevented classification for taxation. Without classification separation was impossible. A clause preventing the release of the local divisions from their proportionate share of state taxes was a further barrier.[2]

Prior to 1910 almost no special taxes, aside from inheritance and poll taxes, were employed. Corporations paid fees and annual licenses, but their property was taxed under the general property tax locally administered—except that the franchise, roadway, roadbed, rails, and rolling stock of railroads operating in two or more counties, although taxed as other property, was assessed by state officials. The only

[1] *Constitution*, sec. 1, art. xiii.

[2] *Ibid.*, sec. 10, art. xi.

special corporation tax was one on the premiums of foreign insurance companies.

The people of the state amended the constitution in 1910, following the recommendation of the commission on revenue and taxation, by repealing all of the clauses preventing separation, and at the same time, not satisfied to leave the development of new methods of taxation to the action of the legislature, they devised and incorporated in the constitution an entire new system of state taxation involving the separation of sources of state and local revenues.

2. HISTORY OF TAXATION IN CALIFORNIA

The general property tax was introduced in California in 1850, the first year of its existence as a state. The other sources of revenue devised in that year were a poll tax, a military commutation tax and a number of licenses. These taxes, excepting a license tax on foreign miners, were locally administered, and the local divisions shared in them.[1] All assessments of property were subject to review by the court of sessions (later by the county board of supervisors), acting as a county board of equalization, but inequalities were complained of from the beginning. In 1869 the state controller asserted that some land was assessed as low as 10 per cent of actual value, and that the inequalities within counties were so great that equalization by a state board, which was then being advocated, would scarcely touch the difficulty.[2] Such a board was created, however, in 1870. The investigations of this board revealed the fact that some land was assessed as low as 4 per cent of real value, and that the county boards of equalization, when equalizing at

[1] W. C. Fankhauser, "Financial History of California." *University of California Publications in Economics*, vol. iii, no. 2, 1913, ch. 2, *passim*.

[2] *Biennial Report of the State Controller*, California, 1867-69, p. 10.

all, were doing so by reducing valuations of the assessors. The ratio varied between different counties, from 15 to 80 per cent, and was estimated to average 42 per cent.[1] In 1872 the powers of the state board of equalization were enlarged so as to permit it to make additions to, or deductions from, individual assessments—with the result that the total valuation of property in the state was more than doubled in that year; but these powers were removed in the following years, until by 1876 the board became a purely advisory body.[2] Largely in consequence of this, valuations dropped (1874) more than $100,000,000. With the new constitution of 1879 and the act of 1880 the state board of equalization was invested with the powers of equalization by counties, and assessment of part of the property of railways,[3] which last had hitherto rested in local hands. The board was not permitted, however, to raise or to lower individual assessments,[4] and assessed valuations remained low and unequal. They were estimated to average 60 to 70 per cent in 1882,[5] 75 per cent in 1888,[6] and 50 to 60 per cent in 1906.[7] Furthermore, under this system real estate everywhere was bearing an undue share of the taxes as compared with personalty. It is not unreasonable, in the light of earlier assessment returns, to suppose that personalty should amount to at least fifty per cent of the total assessment roll, yet in 1905 real estate paid 85 and personalty 15 per cent of the entire state tax,

[1] Fankhauser, *op. cit.*, p. 191. [2] *Ibid.*, p. 238.

[3] *General Code*, sec. 3665.

[4] Wells, Fargo and Company *vs.* the State Board of Equalization, 56 Cal. 194.

[5] *Report of the California State Board of Equalization*, 1882, p. 8.

[6] *Ibid.*, 1888, pp. 4-5.

[7] *Report of the Commission on Revenue and Taxation of California*, 1906, p. 63.

while in 1860 real estate had paid 54. and personalty 46 per cent. From 1872 to 1903 the personal property on the assessment roll remained stationary, while the assessed value of real property increased more than threefold. It was estimated that farmers were paying a tax equivalent to ten per cent of their income, while the tax on manufacturers was only equivalent to a two per cent income tax.[1]

Such was the administration of the general property tax, which was supplying more than half of the state's revenue. Corporations, except foreign insurance companies, were, as stated above, taxed entirely under this tax, aside from minor licenses and incorporation fees.

Until 1879 all railroad property had been locally assessed. The lack of uniformity and equality resulting from this method led, in 1879, to putting into the hands of the state board of equalization the assessment of part of the property of railroads operating in more than one county. The collection of the taxes was left at first to county officials, but owing to the trouble made by the railroads these supervisors often accepted smaller sums than were due lest they secure nothing at all. In 1883 the state controller was made responsible for the collection of these railroad taxes and better results were obtained; however, there was still a great deal of litigation, based largely on the question of whether or not a state might tax a railroad incorporated under the laws of the United States. This was finally settled in favor of the state[2] and back taxes were paid in 1894. The system of taxing railroads, as it stood before the amendment of 1910, was as follows: All railroad property operated in more than one county, *i. e.*, the franchise,

[1] *Transactions of the Commonwealth Club of California*, vol. iii, 1908, p. 104.

[2] People *vs.* Central Pacific Railroad Company, 105 Cal. 576, and Central Pacific Railroad Company *vs.* California, 162 U. S. 91.

roadway, roadbed, rails and rolling stock—was assessed by the state board of equalization, this assessment being apportioned among the counties and local divisions in proportion to the railroad mileage in each. Until 1906 the board attempted to ascertain the actual value of railroad property, but after 1906 it substituted an assessed valuation which, when added to the valuation placed on locally assessed operative property, would yield, at the tax rate of the previous year, a sum equal to four per cent of gross receipts from operation. This method was easier to apply and the results were believed to be substantially the same. The assessment of all other property was left to local assessors. All state and county taxes levied upon the assessments made by the state board were paid directly by the railroad to the state, which paid to the counties their share, levied at the rate on other property in each county.[1]

In addition to these taxes, the railroad paid directly to the counties taxes on the property assessed by the counties, and to the cities, and to the counties for special school purposes, taxes levied both on the mileage and on other property in the cities or in the school districts. State administration, as far as it went, was fairly satisfactory. The total yield from this source in 1904 was nearly $2,000,000. But the system was unnecessarily complex. Street railroads were assessed locally and taxed in much the same manner as other property.

The Pullman Company and some other car companies, before 1910, were assessed by the state board of equalization, the assessment being based on the number of cars operated within the state during the year and the state's proportion of those used in interstate business. They paid

[1] For a discussion of the methods of taxing railroad and other corporate property before 1910, see the *Report of the Commission on Revenue and Taxation*, 1906, *passim*.

taxes on that assessment as well as on local assessments in the same manner as railroads. The amount paid in, in 1905, was $18,831, the larger part of which was paid by the Pullman Company.

Other car, freight and express companies came under the law of 1905 imposing an annual license tax on all corporations. They also paid license taxes in some cities. In addition, state and local divisions obtained what they could through the general property tax. In 1905 express companies paid in taxes, exclusive of licenses, less than $15,000, most of which was paid by Wells, Fargo and Company. Many of the small companies escaped entirely.

Telegraph and telephone companies were assessed locally and taxed under the general property tax. In addition, the telephone companies were subject to local licenses. Under this system the taxes on telephone companies amounted to 2.65 per cent of gross earnings; those on telegraph companies equaled 1.66 per cent.

Light, heat, and power companies were likewise assessed and taxed under the general property tax. Their taxes amounted to about 3.03 per cent on gross earnings.

Under the same system water companies in 1905 paid 7.09 per cent on gross earnings, except the Spring Valley Water Company, which paid 16.09 per cent.[1]

The provisions for the taxation of banks before the amendment were difficult to apply and unjust when applied, and the results were most unsatisfactory. National banks, owing to the conflict between California and federal statutes, could be taxed only on real estate. The revenue laws were amended in 1899 to reach such banks more effectively, but the amendment proved defective and was finally de-

[1] No objection was made to this heavy tax since the company was permitted to charge rates yielding a "fair return" on capital, and thus easily compensated itself for the loss in taxes. (*Commission on Revenue and Taxation*, 1906, p. 216.)

clared unconstitutional, in 1904, on the ground that it discriminated against national banks, inasmuch as they were taxed on the value of shares, which includes good will, and state banks were taxed on property, which does not include good will. No further attempt was made to tax the national banks except on their real estate, and in consequence they were paying in taxes less than one-fifth of what they would have paid if assessed as other property.

State commercial banks paid taxes on all property, with the privilege of deducting debts from solvent credits. Since the bank's debts, which included the amount owed to depositors, generally exceeded the credits, their deduction left nothing, or at least very little, which could be taxed. The deposits were taxed to the depositors, and as they were rarely reported a large amount of taxable property (equal to about one-fifth of the total assessment roll) escaped. The tax on general franchises was applied to these banks, the valuation being made by subtracting the value of tangible and exempt property from the market value of the stock, and assessing the remainder at a fraction (about one-fourth) of the value attained to allow for the under-assessment of other property and to avoid taxing good-will. The banks paid this under protest, claiming that good-will which should not be taxed was included, but one decision [1] stated that all corporate excess was taxable even though it included good-will.

Savings banks were taxed in the same way, except that their solvent credits were taxed without allowance for deposits. The result was that they were paying a much higher tax than the commercial banks, although their tax was not excessive.

In 1905 the taxes levied on national banks in California equaled twenty cents on one hundred dollars of capital;

[1] Bank of California *vs.* San Francisco, 142 Cal. 276.

those on state commercial banks equaled eighty cents on one hundred dollars; and those on savings banks amounted to one dollar and twenty-five cents.

Another objectionable feature of this system of taxation, in addition to its inequitableness and inadequacy, was the restriction on the field of investment. Owing to the advantage of owning the untaxed stocks and bonds of California corporations there was a tendency to exclude foreign capital.[1]

The taxation of insurance companies before 1910 was characterized by a lack of uniformity. There was discrimination between life- and fire-insurance companies, between domestic and foreign insurance companies, and between foreign insurance companies of different states. Foreign insurance companies were subject to the only special corporation tax in California—a tax on gross premiums.[2] The method of taxing foreign life-insurance companies was slightly different from that of taxing other foreign insurance companies, although the burden of the tax was approximately equal on both. Owing to a retaliatory provision only companies incorporated in Connecticut, New Hampshire and Minnesota, which had the lightest insurance taxes, came under the rate provided. All domestic insurance companies were taxed under the general property tax. In addition, agents or companies were subject to local license taxes. Under this system the companies paid, in 1905, $148,000.

Industrial corporations in California were taxed entirely under the general property tax before the amendment of 1910. The franchise value, which was recognized as a

[1] *Report of Commission on Revenue and Taxation*, 1906, p. 239 *et seq.*

[2] This tax was imposed by laws of 1903 and 1904. A gross premium tax on foreign insurance companies had also been levied for a brief period once before (1864-1872). (Fankhauser, *op. cit.*, p. 201.)

value arising from the privilege of corporate existence (with or without special privilege) common to all corporations, was specifically included in the value thus taxed.[1] Assessments under this method were most irregular. Many, and in some years most, counties reported no assessable franchises, although they doubtless possessed some. Further, the amount assessed varied greatly from year to year. In 1896, for example, the value assessed was but little more than a quarter of the value two years before.[2] An incorporation fee, graduated according to capitalization (sometimes referred to as a tax on the franchise "to be") was also imposed.

The remainder of the revenue for state purposes was obtained from the poll and inheritance taxes, fees, and income from state lands, institutions and other property. The poll tax was an annual state tax of two dollars. It was estimated that about one-half of the men subject to the tax avoided paying it.[3] The inheritance tax was at first (beginning 1893) levied on collateral heirs only, but in 1905 it was extended to all heirs, and the tax was graduated.

The revenue from these sources, together with that from corporation license taxes and taxes on insurance premiums constituted the revenue from separate sources, which formed a large and gradually increasing part of the total state income before 1910. It amounted to about thirty per cent of the total revenue in 1900, and about forty-four per cent in 1910.[4]

Aside from the difficulties everywhere encountered in trying to use the general property tax as the central state tax,

[1] *Report of Commission on Revenue and Taxation*, 1906, p. 267 *et seq.*

[2] *Ibid.*, p. 58 *et seq.* See also C. C. Plehn, "Taxation of Franchises in California," *National Municipal Review*, vol. i, no. 3, p. 34.

[3] *Report of the Commission on Revenue and Taxation*, 1906, p. 48.

[4] Computed from data in the *Reports of the State Controller* for these years.

evils resulted from this system which were peculiar to California.[1] In a state where population is evenly distributed and conditions are fairly homogeneous the system might have worked very well. But in California there are two large, thickly populated commercial regions, and outside of these a vast area which is agricultural or mountainous, and sparsely settled. Whenever an attempt was made in one of these commercial centers to tax the franchise of a corporation the corporation simply moved its "head office" to some rural place where the assessor could not reach it.[2]

An even greater evil resulted from allowing the counties to collect a tax from railroads according to the mileage within the county. There are three gateways of traffic in California which take the through lines east over large uninhabited areas. The result of subjecting these lines to local taxation was to give large sources of revenue to counties having little need of money and contributing little to the value of the sources which they tapped. San Francisco County taxed twelve miles of railway while San Bernardino County taxed seven hundred miles. San Francisco County, in 1910, received 1.5 cents per capita from railroad taxes while San Bernardino County received $2.68. Some counties received even more than San Bernardino per capita, the highest obtaining nearly $4. San Francisco's railroad tax that year amounted to 0.073 per cent of her property tax; Placer County's equaled 37.6 per cent.[3]

Another evil of the system, similar to the one just mentioned, was that the large power plants in the Sierras brought in a disproportionately large revenue to the sparsely settled counties in which they were located.[4]

[1] *Conference*, 1911, p. 115.

[2] This has also occurred in New York. *Report of the Joint Legistive Committee on Taxation*, 1916, p. 93.

[3] Computed from data in *Controller's Report*, 1909-1910.

[4] *Conference*, 1911, p. 117.

TABLE IX[1]

CALIFORNIA STATE REVENUES, 1900, 1910

Source	*Amount 1900*	*Per cent 1900*	*Amount 1910*	*Per cent 1910*
Total	$10,290,866	100	$16,931,166	100
General Property	6,797,034	66	8,436,048	50
Railroad	278,335	3	437,744	2
Separate Sources	3,215,497	31	8,058,175	48
FROM SEPARATE SOURCES				
Total	$3,215,497	100	$8,058,175	100
Poll	404,574	13	687,953	8
Inheritance	385,362	12	883,640	11
Insurance	50,038	2	435,365	5
Corporation License	....	....	745,605	9
Other	2,375,723	73	5,305,612	67

Before separation local revenues were obtained principally from the general property tax. The county and state property taxes were based on the same assessment; but cities often reassessed their property at a higher rate in order to keep their tax rate below the limit imposed by their charters.

In the year 1909-10 the towns obtained $20,000,000 from property taxes,—this being nearly two-thirds of their total ordinary revenues.[2] The remainder was derived from licenses, fees and fines. The counties in the same year obtained from ths source $26,000,000, just two-thirds of their ordinary receipts. They also obtained $6,500,000 as subventions on account of railroad taxes collected by the state, and as aid to schools. Other important sources of county revenue were licenses, fees, fines, interest on county moneys, commissions, and county poll taxes.

3. ACHIEVEMENT OF SEPARATION IN 1910

As early as 1894 the growing dissatisfaction with the

[1] Compiled from data in *Controller's Reports.*

[2] *Annual Report of Financial Transactions of Municipalities and Counties for the Year 1911, passim.*

existing revenue system resulted in the appointment, by the legislature, of a committee of investigation. The recommendations of this committee were acted upon by the legislature but failed to produce any desired reform.[1] The matter came up again in 1899, when a committee of three senators was appointed by the legislature. This committee investigated, and reported in 1901, but its recommendations were rejected.[2] In 1903 Governor Pardee in his inaugural address recommended further investigation with a view to fiscal reform.[2] He advised a gradual rather than a radical change in the system. This was followed in 1904 by the endorsement by the Commonwealth Club of California of the propositions (1) to abandon the attempt to support all of the departments of government by the same method; (2) to give up the endeavor to reach intangible personalty in the hands of the owners; and (3) to cease trying to use the general property tax for both state and local purposes.[3]

In 1905 Governor Pardee urged the legislature to propose a series of amendments to the constitution increasing the powers of the legislature in matters of taxation, and as a result of this an act was passed by the legislature creating a commission on revenue and taxation for the purpose of investigating the revenue system and recommending a plan of revision. This commission was composed of two senators, two assemblymen, Professor Carl C. Plehn and the governor as chairman. After examining the systems used in other states and investigating conditions in California the commission published a report of its findings in 1906. The plan of revision recommended was the separation of the sources of state and local taxes and the ultimate abandon-

[1] Fankhauser, *op. cit.*, p. 368. [2] *Ibid.*, p. 369.

[3] *Commonwealth Club*, vol. i, June, 1904.

ment of the general property tax by the state.[1] A constitutional amendment was necessary to effect this.

The legislature adopted a resolution proposing the necessary amendment in March 1907. It was submitted to the people in November 1908, but was defeated by a majority of more than 25,000 votes.[2] The defeat was believed to be due largely to the political intrigues of corporations and interests whose taxes would be increased by the new system[3] although almost the only undisguised opponents were the city assessors, whose services, it was supposed, would be dispensed with under the new system, since the expected rise in the assessment ratio would make unnecessary the separate valuation of city property to keep the tax rate below the limits set by the city charters. Some opposition came from the Commonwealth Club of California because it was felt that an income tax on corporations would be fairer, and because no change was made in the manner of electing the state board of equalization whose members, it was urged, should be elected at large. There was also a fear that the burden of taxation, even though as heavy on corporate as on other property when the law was first enforced, would not remain so, since the rates were fixed in the constitution; moreover the corporation tax was a state tax, and state taxes are not increasing as rapidly as local taxes. Professor Plehn's answer to this last objection was that while the rate was fixed the amount of the taxes grew with the increased earnings of the corporations, and while the local taxes were increasing very rapidly it was proper that local property should bear the burden of local expenditure,—in brief that a just system is not one which taxes all property at the same

[1] *Report of Commission on Revenue and Taxation*, 1906, p. 77 *et seq.*

[2] *Ibid.*, 1910, p. 12.

[3] *Conference*, 1911, p. 120.

rate, but rather one which places the burden where the benefit is received,—when such benefit is direct and measurable as it is in a large degree in local systems.[1]

The principal defects pointed out in the 1908 amendment were matters of detail, *viz.*, that (1) no provision was made for meeting a deficit in case of insufficient revenues; that (2) the amendment was not clear concerning the liability of withdrawn public-service corporations to taxation to pay their share of the interest and principal on past bonded indebtedness of local divisions; that (3) should a deficiency tax be found necessary the corporations taxed for state purposes would be exempted, and this would place too heavy a burden on the remaining property; and finally that (4) no provision was made for changing the rates should they be found unfair.[2]

A second amendment obviating these difficulties was then proposed by the commission [3] and adopted by the legislature of 1909. This was voted on and ratified by the people on November 8, 1910, by a majority of 45,000 votes.[4]

The amendment thus adopted provided for the complete separation of the sources of state and local taxes. The subjects taxed exclusively for state purposes were public utilities (except water companies), banks, insurance companies, and the franchises of all other corporations. All public utilities were to be taxed a specified percentage of gross receipts from operation within the state. The gross receipts

[1] *Commonwealth Club*, May 1908, p. 140.

[2] *Report of the Commission on Revenue and Taxation*, 1910, pp. 12-13.

[3] The commission, having completed the work for which it was created, was reorganized by legislative act on March 24, 1909. The number was reduced to one commissioner, Senator J. B. Curtin and the secretary Professor C. C. Plehn. Its work was to show the effect of the proposed amendment in operation.

[4] *Special Report of State Board of Equalization on First Effects of Separation* (Sacramento, 1911), p. 3.

tax was chosen as the fairest practicable tax which could be devised, and it was attempted to make the tax for each class of corporations bear the same relation to the capital value of the corporation as the general property tax bore to the property on which it was levied. The method chosen for determining the rate of taxation on gross earnings which would be the equivalent of a given tax rate on the property yielding the gross earnings was to

(1) ascertain what percentage of the gross earnings is net, (2) ascertain what rate of interest would constitute a fair return to investors in the securities of the class of public-service corporations under consideration, then (3) divide the percentage of net earnings by the rate of interest and multiply the result by the given tax rate on property.[1]

This is expressed by the algebraic equation $t = \frac{n}{i} \times r$. Since it was held that within each class of public-service corporations the percentage of net earnings to gross was about the same,[2] approximate equality would be attained by using the same percentage for all of the corporations in each class.

It was estimated that the average rate on general property would be about one per cent under the new system, and this was used as the basis for determining the rates on gross earnings.[3] Although the value of general property used in making the comparisons was the discounted value of its expected future earnings, while the value of corporate property was determined by capitalizing present earnings, the valuation placed on corporations was not in most cases lower than that on other property, even though the rate of earnings usually increases as corporations develop. This is due

[1] *Report of the Commission on Revenue and Taxation*, 1906, p. 94.

[2] This has been demonstrated by the stock and bond valuations made since. (*Stock and Bond Valuation of Public Utilities in California*, 1916.)

[3] *Report of the Commission on Revenue and Taxation*, 1906, pp. 99-100.

to the fact that the rate of interest used in the formula was low enough to include discounted future value.[1]

The percentages computed for the different classes of public utilities on their gross receipts from operation were as follows: railroad and street railways, 4 per cent; car companies, 3 per cent; express companies, 2 per cent; telegraph and telephone companies, 3.5 per cent; gas and electric companies, 4 per cent.[2] These percentages were changed by the legislature in 1913 following a general rise in the rate on general property and on investigation by the state board of equalization which revealed certain inequalities. A further change, in 1915, leaves the rates for the present as follows: railroads and street railways, 5.25 per cent; car companies, 3.95 per cent; express companies, 1.6 per cent; telegraph and telephone companies, 4.5 per cent; gas and electric companies, 5.25 per cent.[3] These taxes are in lieu of all other taxes, except local taxes on non-operative property.[4]

Every insurance company doing business in the state was taxed, in 1910, 1.5 per cent upon the amount of gross premiums and reinsurance in companies authorized to do business within the state. This rate was made 2 per cent in 1915. This is in lieu of all other taxes except taxes on real estate, the amount of which is to be deducted from state taxes. The retaliatory clause is retained.

[1] According to the statement of Professor Plehn.

[2] *Report of the Commission on Revenue and Taxation*, 1910, p. 14.

[3] *Report of the State Board of Equalization for 1915-1916* (Sacramento, 1916), p. 23.

[4] Public utilities under construction are classed as non-operative property until the state board of equalization shall determine that they are "rendering a substantial public service within the state." Operative property is defined as "any . . . property . . . that may be reasonably necessary for use by said (public service) companies exclusively in the operation or conduct of the particular kinds of business enumerated in Section 2 of this act," *i. e.*, when performing a public service.

All incorporated banks are taxed 1.2 per cent [1] (1915) on the amount of stock paid in, plus its *pro rata* of accumulated surplus and undivided profits. The shares of stock are assessed and taxed to the owners at the place where the bank is located, and the bank is held liable to the state for the tax, and may assume it. This tax is in lieu of all other taxes except local taxes on real estate. The value, as assessed by the county, of any real estate, other than mortgage interests therein, which is taxed for county purposes, is deducted from the capital value of the stock assessed for the state tax.

All franchises,[2] other than those expressly provided for, are taxed 1.2 per cent on their actual cash value.[3] This value is determined by subtracting from the total market value of all outstanding securities the assessed value of tangible property, but discretion is exercised in arriving at the assessable value.

Should the revenues from these corporation taxes, together with the revenues from sources retained from the old system, prove insufficient, a state tax may be levied on all property, including that subject to the state corporation taxes, in order to meet the deficiency.[4]

[1] This was made 0.6 per cent in the amendment as first approved by the senate, March, 1909, but was raised to one per cent shortly before the amendment was submitted to the people in November 1910. (*Conference*, 1911, p. 123.)

[2] This includes the rights "to be" and "to do" and special privileges.

[3] The statutory provision, sec. 5, approved Feb. 3, 1913, states that "due deduction for good will shall be made." No provision for such deduction is, however, made, and it has been held (by Judge Sturtevant of the Superior Court of San Francisco) that the legislature exceeded its powers in stating that such deductions should be made, since "good will" is included in the value of the franchise. Since, however, the value of the franchise is taken as only fifteen per cent of its true value, due deductions are in fact made.

[4] This and the two provisions following were added to the amendment in 1910 in order to get sufficient support to get it ratified. (*Conference*, 1912, p. 70 *et seq*.

All public utilities, insurance companies and franchises are subject to taxation to pay the interest and principal on the bonded indebtedness of local divisions incurred before the amendment went into effect; the amount thus levied is to be deducted from total state taxes.

Until 1918 the state is to reimburse all counties which sustain loss of revenue by the withdrawal of railroad property from county taxation, in order that the counties may have time to adjust themselves to the new system.[1]

The provisions of the amendment are made self-executing; the rates of taxation can be changed only by a two-thirds vote of the legislature; there may be no proceedings to prevent the collection of taxes, but, once paid, action may be taken to recover those illegally collected. By statutory enactment in 1911 and 1912 the state board of equalization was invested with ample powers for obtaining the necessary information and proper punishments were provided for failure to comply with the law. Consequently no difficulties were experienced in enforcing it.

Since the general property tax was the only tax for state purposes abolished by the new system, receipts from fees, poll taxes, inheritance taxes, the corporation license tax, and revenues from state property and institutions remained as before. The retention of the corporation license tax together with the new corporation taxes was held to result in double taxation and by the decision of H. K. Mulford Company *vs.* Curry, Secretary of State (163 Cal. 276), foreign corporations were exempted from its provisions, since the constitution provides that foreign corporations

[1] Owing to the great difficulty of determining the actual net loss of each county, it was found expedient (1911) for the legislature to provide for reimbursement by the payment of flat sums to the losing counties. The counties in turn reimburse those road and school districts which lose. (*Biennial Report of the State Controller*, 1912, p. 21.)

shall not do business on more favorable terms than domestic. The tax was repealed in 1913 but reënacted in 1915, following a reversal of the decision in the Mulford case (Albert Pick Co. *vs.* Jordan, Secretary of State). The poll tax was repealed in 1914.

4. ADMINISTRATION OF THE NEW LAW

After a trial of two years the administrative officials pronounced the new system practicable,[1] and there has apparently been no change of opinion since. The work of assessment for state taxes proved at first to be very heavy, and the state board of equalization was relieved of none of its former duties, except a certain amount of equalization of county assessments, for it had to continue its regular assessment work for the Panama-Pacific Exposition tax and the bond redemption taxes. Because of the pressure of work it was found necessary to leave assessments for bond refunds to local assessors, subject to state supervision.[2]

Although its duties were for a time exacting, the board met with but few difficulties in the new work. The tax on gross receipts was found easy to administer, and the public service corporations coöperated willingly in giving the necessary information. Investigation of their sworn reports resulted in but few corrections, and these were such that the amount of taxes due to the state was slightly reduced.[3]

Some technical difficulties arose in assessing banks, due to the custom of keeping the books in such a way as not to make too favorable a showing (this being in the interest of sound banking). It was also found difficult to get a correct statement of undivided profits, some of which are carried as interest, exchange, collection and dividends un-

[1] *Conference*, 1912, p. 170.

[2] *Report of Controller*, 1912, pp. 28-29.

[3] *Conference*, 1911, p. 125.

paid. There was a little trouble from the undervaluation of assets, this being good business policy, but in the end satisfactory results were obtained.[1]

Considerable difficulty was met at first in determining franchise values. The amendment states that franchises are to be assessed at their actual cash value, in the manner to be provided by law. The legislature did not prescribe the method of assessment but left it to the discretion of the state board of equalization whose members were forced to determine, as best they could within four months, the value of about twenty thousand franchises.

The greatest difficulties in administration are due to the compromises made with the local divisions, *viz.*, railroad reimbursements and bond refunds, which the commission resorted to in order to have the amendment ratified in 1910. The Panama-Pacific Exposition tax also complicated matters for a time.

The net loss in county revenues due to the withdrawal of railroad property from county taxation is assumed to be the amount which the county would have obtained from the taxation of railroads under the old system, less the amount the county would have had to pay to the state under the *ad valorem* tax. To ascertain this amount would necessitate computing both the constructive state rate on property and the constructive county tax rate on railroads as they would have been under the former system. This is not only difficult to accomplish but also inequitable, owing to the changes in the proportion of assessed to real values. Consequently, although the original intention was to ascertain these rates, it had to be abandoned, and a statute was passed in 1911 providing for the payment of flat sums to the counties originally sustaining a net loss of revenue.[2]

[1] *Conference*, 1911, p. 131.

[2] *Report of Controller*, 1912, pp. 20-21.

This occasioned dissatisfaction on the part of some of the counties, which maintained that their reimbursement did not cover their loss. However, in 1912 some of the counties received by this method more than they would have received had the original method been adhered to, and less objection was made. Complaints as to the injustice of this reimbursement were also received from counties sustaining no loss from the withdrawal of railroad property from county taxation but suffering from the withdrawal of other corporate property such as power plants.

The bond refund payments[1] have been made by the appropriation of fixed sums by the legislature, to be apportioned among the counties and local divisions entitled to them, the state having previously collected taxes without deductions from the corporations. In order to make these payments it was necessary to determine the exact amount of bond debts existing and outstanding before the law went into effect.[2] Irrigation and reclamation districts were not included in those entitled to bond refunds since their levies are held by the attorney general to constitute special assessments rather than taxes. They are therefore entitled to assess the property of withdrawn corporations, and to collect such assessments regardless of state taxes on these corporations. The claims originally presented by the local districts exceeded those eventually paid, but the final adjustment was in most cases accepted as satisfactory.

The counties have increased the amount due from the state in bond refunds in two ways: by making the interest and principal of the bonds of public utilities subject to payment by taxes, where they were formerly paid out of the earnings of the utilities for which the bonds were issued; and by raising the assessment of operative property.[3] As-

[1] *Supra*, p. 144. [2] *First Effects of Separation*, p. 28.

[3] *Report of Controller*, 1912, p. 30.

sessments for the payment of bond refunds are made by the local assessors, subject to state supervision. It is to the interest of local districts to assess operative property at a higher rate than non-operative, since this will cause the state to pay a relatively greater amount of the bond interest and principal than the locality; and the corporations, being taxed by the state on gross earnings, are not interested in keeping down the valuations. The result has been that, in spite of state supervision, there has been a disproportionate increase in operative property assessments. The increase in the fiscal year 1911-12 was, for operative property, 27.4 per cent,—for non-operative, only 11.2 per cent. To take an extreme case one city increased its operative property valuation 67 per cent in that year and its non-operative only 10 per cent. In another instance the operative roll was increased 45 per cent while there was an actual decrease in the non-operative assessments.[1] In 1914 the valuation of operative property had increased 50 per cent over 1911, while that of non-operative property had increased less than 23 per cent.[2] The extension, by the auditors and clerks, of these bond taxes against the personal property of banks, which is exempt under the amendment, also was a cause of difficulty.

The Panama-Pacific Exposition tax was a state *ad valorem* tax on all property, corporate and individual, for the purpose of raising $5,000,000 for the Exposition.[3] It was temporary, running only for the four years 1911 to 1914 inclusive, and amounted to less than five cents on a hundred dollars. Consequently it did not seriously interfere with the working of the new scheme. But it necessitated continuing the old system along with the new, and to a limited

[1] *Report of Controller*, 1912, pp. 258-261.

[2] *Report of the State Board of Equalization for 1913-1914*, p. 10.

[3] *Ibid.*, 1911-12, p. 5.

extent retarded the benefits of the new and retained the evils of the old.

5. LITIGATION

The constitutionality of the various provisions of the amendment has been thoroughly tested. A series of actions has been brought against the state, beginning in 1912, by the corporations which have protested the payment of their taxes, for the purpose of recovering taxes paid, and determining the validity of the new law. The cases have involved questions of double taxation, the correct interpretation of "gross receipts from operation" and the inclusion in such gross receipts of specific earnings, the validity of such a tax (the claim being advanced that it was a tax on interstate commerce), the proper classification of property as operative and non-operative, and, on various grounds, the validity of the state assessment of corporate franchises. Most of these have been decided in favor of the state, and none of the adverse decisions has affected the operation of the law.[1]

6. SHIFTING OF THE TAX BURDEN

The aim of separation was so to adjust the burden of taxation that it would be borne equitably by all property, of whatever kind or wherever situated. Before separation, as explained above, there were inequalities between different counties and between different kinds of property. By the removal of the state tax on general property it was hoped that assessed valuations would approach true values, and that all property within each local division would be assessed at the same ratio. The tax rate would, of course, vary somewhat from district to district, but since the taxes are used for local purposes that property taxed most heavily

[1] *Report of the State Board of Equalization*, 1912, pp. 12-14; 1914, pp. 20-21; 1916, pp. 19-20.

would benefit the most, and consequently there would be no injustice. By putting the taxation of corporations into the hands of the state, and changing the method of levying taxes, it was expected that the greater part of intangible property, which was escaping under the old system, would be reached.[1]

In the six years during which the law has been in operation there has been a decided shifting of the tax burden. Just how far this shifting has gone, and to what extent it has equalized, is hard to discover; but the state board of equalization has attempted with some success to measure it, and the results obtained show, at least approximately, the effect of the new law on property taxed locally, and on the corporations taxed by the state.

According to the estimates made by the state board of equalization the ratio of the assessed to the real value of property taxed locally varied in 1912 from 24.8 per cent (Butte County) to 70.2 per cent (Mariposa County), averaging 45.1 per cent.[2] A more recent estimate (1916) by the state tax commission places the ratio of assessed to true value at 43 per cent.[3] Whether assessed values will eventually rise to approximate the true value of property is still a matter for debate. Local assessors probably held back at first, partly on account of the Panama-Pacific Exposition tax, and partly in expectation of a return to the state *ad valorem* tax in case of insufficient revenues. The possibility of the latter may still be influencing their action. The rise

[1] *Report of the Commission on Revenue and Taxation*, 1906, p. 87 *et seq.*

[2] Computed from data in the *Special Report of the State Board of Equalization on the Relative Burden of State and Local Taxes of 1912.* (1913), p. 41.

[3] *Report of the State Tax Commission of California*, 1917. (Sacramento, 1917), p. 15.

in assessed values, of twenty-three per cent between the years 1910-11 and 1912-13, and eleven per cent between 1912-13 and 1914-15, and again between 1914-15 and 1916-17,[1] is apparently due to increases in the actual value of assessable property.

The average tax rate, state and local, on the assessed value of non-operative property was, in 1915, \$2.27, 1914, \$2.44, and in 1913, \$2.53, as compared with 1911, \$2.40 and 1906, \$1.82.[2] The average rate on actual value was estimated in 1915 to be \$1.22 and in 1913, \$1.14.[3]

The average rate for municipalities has risen as follows:

TABLE X[4]

MUNICIPAL TAX RATE

Year	*Rate per \$100 assessed value*	*Rate per \$100 assessed value had operative property been included*
1910–11	\$1.47	\$1.47
1911–12	1.69	1.51
1912–13	1.58	1.37
1913–14	1.75	1.52
1914–15	1.76	1.53

In spite of the increased local rates, due to the increasing demand for revenue and to the withdrawal of operative property, non-operative property is taxed less under separation than it would have been under the former system.

[1] Computed from data in *Reports of the State Board of Equalization.*

[2] Computed from data in *Report of the State Controller.*

[3] This rate is the ratio of total taxes (Panama-Pacific Exposition tax included) to the appraised value of property, as made by the state board (*Reports of the State Board of Equalization*, 1914, 1916); which appraised value is, as nearly as could be ascertained, equal to the full cash value of property. It was estimated before separation that under the new law this rate would be \$1.00 per \$100 on the real value of all property, in whatever manner or by whatever agent taxed.

[4] Estimated from data in *Annual Report of Financial Transactions of Municipalities and Counties of California*, 1911-1915.

Assuming that the same amount of revenue would have been collected for local purposes under the old system, had it remained in use, a rate of $2.29 on all property would have resulted in the same revenue as was raised by a rate of $2.53 in 1913. Consequently if a state tax of thirty cents per $100 [1] had been added to this the tax rate on property would have been $2.59, or six cents higher than it actually was in 1913. Thus while the burden on property is heavier than it was before separation, it is not as heavy as it would have been had the old system remained.

Turning to the burden on subjects taxed by the state, it will be seen that a decided increase has been realized. Through the method of capitalizing net earnings already explained [2] the commission computed the rate of taxation on gross earnings which would equal, according to its estimates, one per cent of the capital value of the different public service corporations. Applying the same method in 1911, with the gross and net receipts for that year, approximately the same results were obtained except for express and car companies. These results are as follows:

TABLE XI [3]

RELATIONSHIP OF NET TO GROSS RECEIPTS OF CALIFORNIA PUBLIC UTILITIES, 1906 AND 1911

Class of Utilities	*1906 Percentage*	*1911 Percentage*
Steam and Street Railroads	36.00	36.86
Gas and Electric	36.00 [4]	38.23
Telegraph and Telephone	20.00	21.10
Car Companies (Pullman)	36.00 [1]	14.55
Express	15.00	8.64 [2]

[1] (See p. 153). [2] (See p. 153).

[1] Approximately the excess of the state tax under the former system over the Panama-Pacific Exposition tax under the present system.

[2] *Supra*, p. 142 *et seq.*

[3] *Special Report on the Relative Burden of State and Local Revenues*, 1912, pp. 16-17.

[4] Because of the rapid depreciation peculiar to these companies the commission, in 1906, found it impossible, or at least impracticable, to

In the cases both of the car and the express companies, the percentages recommended by the commission, four to five per cent in the first case, and three per cent in the second, were reduced by the legislature to three and two per cent respectively. Thus these companies have not been unduly overburdened.[3] But the ratio of net to gross earnings is found to vary greatly with different companies. These variations were computed in 1911 to be as follows:

TABLE XII[4]

RATIO OF NET TO GROSS EARNINGS OF CERTAIN PUBLIC UTILITIES IN CALIFORNIA

Railroads and Street Railways	Deficit to 62.0 per cent
Gas and Electric Companies	Deficit to 75.5 per cent
Telegraph and Telephone Companies	0.5 to 90.0 per cent

The computations for express and car companies included in each case only a single company, *viz.*, Wells, Fargo and Company and the Pullman Company.

compute the ratio of net to gross receipts. Instead an estimate was made of the value of the property by ascertaining the cost of construction and equipment. It was assumed, in taking this "book value," that should it be higher than the cost of reproduction, the difference would be more than made up by the value of the franchise, which was not included in the cost of construction. It was found that one per cent of this cost was about the same as five per cent of gross earnings, and consequently a rate of four to five per cent on gross earnings was recommended by the commission.

[1] The inaccurate computation of the ratio of net to gross receipts, 1906, was due to insufficient information. The Pullman Company did not in that year furnish the board with a statement of earnings and this estimate was made from what data could be obtained elsewhere.

[2] This is for Wells, Fargo & Company only. It includes what is paid to the railroads for "express privileges." Were these payments excluded from the estimates of gross receipts (the law forbids their exclusion) fifteen per cent would still be the ratio of net to gross receipts.

[3] *Cf.* present rates, *supra*, p. 144.

[4] *Special Report on the Relative Burden of State and Local Revenues*, 1912, *passim*.

The state board of equalization, in order to test further the burden of the new taxes, made valuations of the companies by the "stock and bond" method. This method consists in ascertaining the market value of stocks and bonds, and multiplying the number outstanding by their respective prices. The ratios of taxes to valuations obtained by this method are as follows:

TABLE XIII[1]

RATE OF TAXATION PER $100 ACTUAL VALUE FOR PUBLIC UTILITIES, CALIFORNIA. (COVERING ONLY THOSE COMPANIES VALUED), 1912–1916

	1912	*1914*	*1916*
Railroads and Street Railways	$.91	$1.10	$1.31
Gas and Electric	.75	.88	1.08
Telegraph and Telephone	.91	1.12	1.40
Express Companies	1.54	1.26	1.97
Car Companies	.88	1.54	1.30

The low rate obtained for gas and electric companies (which have the same ratio of net to gross receipts as railroads) is explained by the fact that many of them are just developing, and are not yet operating to full capacity. Consequently their present earnings are small as compared with their expected future earnings.

In the comparison of individual companies within the same class, wide differences in the tax burden are found. The rate obtained by this method varied for railroad companies from .34 per cent to 1.66 per cent;[2] in other words, some roads were paying five times as much in taxes on their estimated stock and bond valuation as other roads. Considering only those roads valued at over $5,000,000, the difference was less, being from .42 to 1.07 per cent.

The variation in gas and electric companies was from .31 to 4.41 per cent; *i. e.*, some companies were paying $1.00

[1] *Reports of State Board of Equalization*, 1912-1916.

[2] *Special Report on the Relative Burden of State and Local Revenues*, 1912, p. 19 *et seq.*

in taxes where others were paying $14.28. When only those companies of $5,000,000 capitalization are considered, the variation is from .31 to 1.18 per cent.

Telegraph and telephone companies were paying anywhere from 63 cents on $100 to $2.50; or, excluding the companies under $100,000 capitalization, from 71 cents to $1.57.

In 1916 the discrepancies appear to be much smaller, owing in part to more accurate accounting in 1916, in part to some inflation of values in 1912.[1] But variations are still large. The burdens are resting by no means equally on the different classes of corporations or on the different corporations of the same class. This is, of course, assuming that "equality" means equal taxes for equal capital value. If gross earnings may be accepted as the criterion, then equality has been attained. There are no data to show equality as measured by net earnings, which is the more satisfactory standard.

In comparing the present burden on public utilities with that before 1910, by means of the rate on gross receipts, a decided increase is shown:

TABLE XIV[2]

ESTIMATED RATE ON GROSS RECEIPTS OF PUBLIC UTILITIES, 1905 AND ACTUAL RATE, 1915

Class	*1905*	*1915*
Railroads	3.64%	5.25%
Street Railways	4.01	5.25
Express	0.514	1.60
Telephone	2.65	4.50
Telegraph	1.66	4.50
Light, Heat and Power	3.03	5.25
Water	7.09	....

[1] Plehn, "Stock and Bond Valuation of Public Utilities in California." *Report of State Tax Commission*, 1916, p. 12.

[2] *Report of Commission on Revenue and Taxation*, 1906, p. 68; *Report of State Board of Equalization*, 1916, p. 23.

The taxes paid by the railroads for state and county purposes on the assessments of the board of equalization were, in 1910-11, $2,163,226, including rolling stock. The remaining taxes, paid on operative property as assessed by local assessors, amounted probably to between six and seven thousand dollars. Thus the total of taxes paid on operative property was nearly a million less in 1910-11 than in 1911-12, when $3,736,000 were paid into the state.[1]

The larger gas and electric companies paid, in 1911-12, about sixty per cent more in taxes than they had been paying; telephone companies had their taxes increased by one hundred per cent, and telegraph companies by two hundred per cent; car companies were increased by fifty per cent. The greatest increase was for express companies whose taxes rose by five hundred per cent.[2]

Bank and franchise taxes being *ad valorem*, it was unnecessary to make any special computations. Their taxes equaled one per cent of assessed value in 1911 and 1912, and the assessed value approximates true value as nearly as it can be estimated by the board. In 1905 state commercial banks had been paying eight-tenths of one per cent on their capital, savings banks 1.25 per cent, and national banks two-tenths of one per cent.[3] Bank real estate is assessed locally at from twenty to sixty-five per cent, averaging about forty per cent of its true value.[4]

Corporations were assessed on franchises in 1911 at $167,500,000 and in 1913, $184,994,300, as compared with $29,190,000 under local assessment in 1910 and $20,142,000 in 1906. The taxes paid on franchises were $1,619,-

[1] *Report of the Controller*, 1912, pp. 10-11.

[2] *Conference*, 1911, p. 127 *et seq.*

[3] *Cf. supra*, pp. 133-134.

[4] Compare with the rate of assessed to real value of 45.1 per cent on other property. *Special Report on State and Local Taxes*, 1912, p. 14.

600 in 1911-12 and $1,557,500 in 1913-14, as compared with $700,600 in 1910-11 and $366,600 in 1906-07.[1] Thus under the new system there are being taxed between $100,-000,000 and $200,000,000 of franchise value which escaped entirely under the old system. Of the $29,000,000 assessed in 1910, a large part was on public service corporations now reached through the gross earnings tax. Therefore the amount of taxes obtained from those corporations paying over $1,500,000 in 1911 and 1912 was considerably less than $700,600 in 1910.

The tax on insurance companies produced $520,200 in 1911-12, and $760,300 in 1913-14. In 1905 only $48,000 were obtained from this source.

To sum up, the rate levied on property taxed locally, while it has advanced slightly since 1910, has not advanced to the point which it would have reached under the old system. The burden has been shifted in some measure from such property to corporate property, which is now paying this as well as its share of the normal increase due to increased governmental expenditures. In consequence, between corporate property and the property of individuals some appreciable equalization has been realized. But among the various kinds of property under the general property tax, among individual properties of the same kind in the same county, and among the properties of different classes of corporations and of different corporations of the same class, there are still serious inequalities—not so great, to be sure, as before 1910, but still far from even approximating equality.

7. REVENUES AND ASSESSMENTS UNDER THE NEW SYSTEM

Along with this shifting of the burden has gone a large

[1] *Cf.* data in *Reports of State Controller.*

increase in revenues in all of the divisions of government. It was anticipated that the cities would be the greatest losers from the change,[1] since as cities they gained nothing through the removal of the state tax (the tax for state purposes having been collected through the counties), while through the withdrawal of operative property, three fourths of which (74.4 per cent 1912) is found within the cities, they would lose heavily. As a result of this it was feared that, since the tax rate is limited by their charters, their revenues would be greatly reduced and serious consequences would ensue. These fears have not been realized.

The total value of operative property withdrawn from municipal taxation was, in 1912-13, $245,000,000. This is thirteen per cent of the total value of municipal property,[2] and it included seventy-four per cent of all of the operative property in the state. Some of the towns contained no operative property, but in several the amount withdrawn was over twenty per cent. In San Francisco the operative property (equal to thirty-eight per cent of all operative property) amounted to fifteen per cent, as assessed in 1912; in Los Angeles, twenty-one per cent.[3]

Following the withdrawal of operative property some increases were made in the ratios of assessment. Los Angeles claimed to have raised her ratio of valuation about ten per cent in the year 1911.[4] The ratio has been raised in Oakland from fifty to sixty per cent, in Pasadena from sixty

[1] *Special Report on First Effects of Separation*, 1911, p. 21.

[2] Computed from *Financial Transactions*, 1912. The value of all operative property in the state equaled twelve per cent of the total value of all property. (*Report of the Controller*, 1912.)

[3] *Report of the State Board of Equalization*, 1912, pp. 20-21.

[4] It was in Los Angeles that half of the increase in city assessment rolls for that year took place. *Special Report on First Effects of Separation*, 1911, p. 21.

to sixty-seven, and in Sacramento from sixty to sixty-eight.[1] None of the other large cities has raised its ratio, although the ratios are only forty to fifty per cent in most of them. To what extent smaller cities have raised their ratios no attempt has been made to determine, but owing to the limitation of the tax rate some cities have probably been forced to raise their valuations in order to obtain sufficient revenue after the withdrawal of operative property.

An examination of the fluctuations of the city tax rates shows no abnormal change. There are more increases than decreases, but this is attributable to growing bonded indebtedness and broadening departmental activities, a natural result of the growth of cities.

No difficulty has been encountered in securing sufficient revenue for municipal purposes.

TABLE XV[2]

MUNICIPAL PROPERTY TAX

Year	*No. of Cities*	*Total Receipts*	*General Property Tax*	*Percentage of Receipts from Property Tax*
1910–11....	133	$46,134,517	$20,045,405	43
1911–12....	191	46,777,804	21,476,153	46
1912–13....	218	60,551,300	24,711,884	48
1913–14....	233	66,830,330	29,714,855	43
1914–15....	240	68,724,579	31,625,161	46

The increase in municipal taxes shown in this table is due in some measure to the larger number of cities included in the estimate each year, but this accounts for only a small part of the growth, since the towns added are small. Eighty per cent of the increase in revenue in 1912 took place in the fifteen largest cities.

[1] Census Report, *Financial Statistics of Cities*, 1909, p. 240 *et seq.*; 1915, p. 318.

[2] *Financial Transactions*, 1911-1915.

The changed system does not seem to have affected the amount of city revenues in any way. Receipts from the property tax, which are the only ones which might be affected by separation, have remained the same relatively to the receipts from other sources, as shown in the above table. San Francisco showed a net gain of approximately $300,000 in 1911-12 and $150,000 in 1912-13.[1] Berkeley alone of the larger cities obtained less revenue from the general property tax the first years after separation.

The amount of bonded debt outstanding in the municipalities in 1911-12 was $65,573,033. The bond refunds paid in the year 1911-12 to the municipalities were $421,997, over $300,000 of which went to Los Angeles and San Francisco. In 1912-13 it was $507,330 and in 1913-14, $517,599. The amounts thus received have increased instead of diminishing, owing to the increase of operative property and to the raising of the ratio of assessed value of operative property above that of non-operative property (which the local assessors have tended to do), and because the interest and principal on bonded indebtedness, which were formerly paid out of the earnings of the public utilities for which the bonds were issued, are now being paid from taxes.[2] However, as the bonds are retired the amount will gradually decrease.

The cities, then, have not suffered from the new law as was feared. While the actual gains and losses have not been computed, it is evident that, with perhaps a few exceptions, neither has been very great. San Francisco, with a loss of fifteen per cent of her assessment roll, and Los Angeles, with a loss of twenty-one per cent, actually gained

[1] This is the only city for which a computation of net gain has been made. (*Special Report on State and Local Taxes*, 1912, p. 23. *Special Report on the Effects of Separation*, 1911, p. 17.)

[2] *Report of Controller*, 1916, pp. 21-22.

through the change[1]—gain from the removal of the state tax exceeding loss through the withdrawal of operative property—and many other cities seem to have done likewise. Tax rates have not increased abnormally, nor have the revenues decreased.

Very little data have been collected concerning the effect on the different districts, but the state board of equalization stated[2] that the losses were small, and in most cases covered by the reimbursement for bond taxes. Provision has been made for reimbursement by the counties for any losses occasioned by the withdrawal of operative property from local taxation. In several counties, notably Riverside, San Bernardino and San Diego, many of the school districts were laid out in such a way as to include as much railroad property as possible. These consequently lost heavily. In Riverside County one school district lost over seventy per cent of its taxable property. In San Bernardino County six districts lost ninety per cent or more of taxable property—one district, Bagdad, losing ninety-seven per cent. This is probably the most extreme case.

The counties have not raised their assessed valuations to the extent anticipated. The total assessment roll increased from $2,370,000,000 in 1911 to $2,919,000,000 in 1912, an increase of twelve per cent, as compared with an increase of ten per cent in 1911.[3] No attempt has been made to determine how much of this is due to a rise in the ratio of assessment, and how much to actual increase in the value of property—but the estimate made in 1916 that the average ratio of assessed to real value was 43 per cent (earlier esti-

[1] *Special Report on First Effects of Separation*, 1911, pp. 17-20.

[2] *Ibid.*, p. 18.

[3] *Reports of State Controller.*

mates were put at 45 per cent) indicates no rise from this cause.

The tax rates as a whole were reduced, and this in spite of the fact that revenue increased. In 1912 forty-two counties had lower inside rates and thirty-seven lower outside rates than in 1910, as compared with eleven with higher inside rates and twelve with higher outside rates. Five inside and nine outside rates remained the same.[1]

The increase in county revenue under the new system has been very decided. As shown in Table XVI, the increase in the tax levy during the first year of separation was ten per cent as compared with only two per cent in 1909-10 over 1908-09. The large increase the first year of separation (1910-11) was in part necessitated by the loss of revenue from railroads, since the state reimbursed the counties only for the net loss from the withdrawal of railroad property, *i. e.*, the difference between what would have been obtained from the railroads under the old system

TABLE XVI[2]

INCREASE IN COUNTY TAX LEVY (EXCLUSIVE OF RAILROAD TAX)

Year	*Amount*	*Increase over Preceding Year*
1906-07	$22,145,000	—%
1907-08	24,200,000	9
1908-09	25,556,500	5
1909-10	26,082,900	2
1910-11	31,188,100	19
1911-12	34,678,200	11
1912-13	37,451,400	8
1913-14	41,032,200	9
1914-15	46,185,700	12
1915-16	47,054,400	2

[1] *Special Report on First Effects of Separation*, 1911, pp. 14-15.

[2] Compiled from *Reports of the Controller*, 1908-1916.

and what is gained through the escape from the state tax on property under the new.[1]

Including the railroad tax in 1909 and 1910, the results are as follows:

TABLE XVII[2]

INCREASE IN COUNTY TAX LEVY (INCLUDING RAILROAD TAX)

Year	*Amount of Levy*	*Increase over Year Preceding*
1908–09	$27,191,900	—%
1909–10	27,663,300	1.7
1910–11	31,188,100	12.7

On examining the counties individually it appears that the effect of the new system on their revenues varies widely. In the first year of the change forty-four counties showed an increase in county revenue and fourteen counties showed a decrease. In 1912-13 nineteen counties showed a decrease.[3] Such individual variations are not entirely caused by the new law, though probably they are considerably affected by it.

The gain to the counties, estimated by subtracting taxes lost on withdrawn operative property from taxes gained through the removal of the state tax on non-operative property, was estimated for 1911 at over $3,500,000.[4] In other words, in order to obtain the same amount of revenue for county purposes as was obtained under the new system (1911-12), the rate on general property would, under the old system, have had to be enough higher to raise $3,500,000 more of revenue from non-operative property alone. This is not, however, clear gain to the counties, for they are

[1] Property must therefore be taxed up to the amount of the state tax (as it would have been under the old system) before any allowance is made for loss from the withdrawal of railroad property.

[2] Compiled from *Reports of the Controller*, 1908-1912.

[3] *Report of the State Board of Equalization*, 1912, p. 22.

[4] *Special Report on the Effects of Separation*, 1911, p. 17.

required under the law to reimburse districts and cities for losses occasioned by the withdrawal of operative property.

According to careful estimates made by the state board of equalization in 1911 [1] it was computed that out of nearly $17,000,000 which would have been paid by the counties to the state under the old system in the two years 1911 to 1913, a sum of approximately $10,000,000 was clear gain to the counties, about half of this amount being used in increased county expenditure, and the other half being kept by the county taxpayers. However, fourteen counties suffered a net loss aggregating over a quarter of a million. This caused considerable readjustment, and therefore some hardship, but the counties suffering were those which had long been profiting from unearned railroad taxes. San Francisco County, though containing 35 per cent of the operative property of the state, showed a net saving in 1911-12.

In 1912 the net saving to the counties was a little under $3,500,000, with twelve counties showing a net loss.[2] For that part of this loss which is due to the withdrawal of railroad property from local taxation, the counties, as has been mentioned, are reimbursed by the state. The difficulties and uncertainties involved in computing the loss,[3] largely owing to the varying rates of taxation and assessment in the different counties, led to the payment of flat appropriations, as more equitable and more practicable. The legislature appropriated $130,901 for each year up to and including the year 1918, to be used for this purpose. Seven counties are thus reimbursed.

[1] *Special Report on the Effects of Separation*, 1911, p. 8 *et seq.*

[2] *Report of State Board of Equalization*, 1912, p. 23.

[3] Such a computation was made by the state board of equalization to show the effects of the new law, but was not used as the basis of reimbursements.

The amount appropriated to reimburse the localities for bond taxes grew from $650,324 in 1911-12 to $742,638 in 1913-14. In the last two years the amount appropriated has decreased (to $635,837 in 1915-16) although claims have continued to grow. It has been the city more than the county refunds that have been increased.[1]

To summarize: The counties, as a whole, show a decided increase in revenue, greater in all probability than would have taken place under the old system, although the county revenues were rising very rapidly before 1910. The tax rates have been somewhat lowered, as was anticipated, in spite of the greater revenues. Assessed valuations in the counties have risen slightly, but not to the extent hoped for. It is, however, too early to tell how far these may be affected by the new law. The net gain to the counties, due entirely to the new system, was very large.

The state revenues have been most affected by separation, since the property tax, the largest source of revenue under the old system, has been entirely replaced by corporation taxes. The revenues from the new sources have exceeded in very instance (except car companies) the estimates made before separation; and a state tax on general property has so far proved unnecessary.

TABLE XVIII[2]

AMOUNT OF CORPORATION TAXES LEVIED

Corporation	*1911*	*1916*
Railroad and Street Railways..	$4,776,203	$6,862,112
Gas and Electric.............	1,224,767	2,441,513
Telegraph and Telephone.....	424,800	861,829
Car.....................	89,262	169,567
Express	102,352	84,186
Banks.	1,638,646	2,235,924
Insurance	520,215	1,065,272
Franchises.	1,677,970	1,957,797
Total	10,454,215	15,678,200

[1] *Report of the Controller*, 1916, p. 20.

[2] *Report of the State Board of Equalization*, 1915-16, p. 15.

TABLE XIX [1]

ACTUAL REVENUES FROM CORPORATIONS UNDER THE GENERAL PROPERTY TAX COMPARED WITH ESTIMATED REVENUES UNDER SEPARATION, 1905

Corporations	*Actual Revenues*	*Estimated Revenues*
Railroads	$1,948,000	$3,800,000
Telegraph and Telephone	143,900	210,000
Express	14,800	120,000
Gas and Electric	424,800	600,000
Car	18,900	75,000
Franchises	364,600	500,000
Banks	721,400	1,500,000
Total	3,635,600	6,805,000

The estimate in 1909 of the total amount of revenue which would have been derived from these sources in that year, had the new system been in operation then, was $8,597,000.[2]

TABLE XX [3]

INCREASE IN REVENUES, 1910–1916

Year	*Receipts*
1910–11	$7,098,000
1911–12	13,115,000
1912–13	15,492,000
1913–14	16,347,000
1914–15	16,516,000
1915–16	19,059,000

The increase in revenue under separation has, as is shown by this table, been very decided. It was for a time seriously questioned whether the increase would continue as rapidly, and it was feared that, without resort to the state *ad valorem* tax on property, it would be impossible to keep state revenues abreast of state expenditures. But the state has adjusted itself to the new system, and for the present at least revenues are sufficient, although there is no assurance that they will continue to be so.

[1] *Report of Commission on Revenue and Taxation*, 1906, *passim*.

[2] *Ibid.*, 1910, p. 27.

[3] Compiled from data in *Controller's Reports*.

The proportion of governmental expenses borne by the state is very large in California. Educational expenditure in 1911-12 surpassed that of any other state except New York, regardless of population.[1] The common schools are supported in large part by the state. The University of California, one of the largest state universities in the United States, is likewise a heavy expense, as also are the normal schools, and high schools. Then the amount spent for the support of charitable institutions is greater than in most states.

The increase in expenditure promises to grow very rapidly. The adoption of the free text-book amendment in 1912 means an addition of approximately $50,000 annually, and appropriations for new buildings and other permanent improvements are increasing steadily. In 1910 the sum of $29,500,000 for bonds was authorized,—mostly for the state highway. In 1914 $15,800,000 more were voted.[2] The situation was further aggravated, in 1914, by the repeal of the poll tax and corporation license tax, which yielded approximately three-quarters of a million each.

To prevent a deficit the rates on corporations were raised in 1913 and again in 1915, following careful investigations which showed that such changes would not raise the burden on corporations above that on general property locally taxed. In addition a motor vehicle tax was enacted in 1913, which yields over $1,000,000 to the state,—as well as an equal amount to the counties. This is devoted to highway expenses and relieves the strain on the general fund to that extent. The corporation license tax was reënacted in 1915 following a reversal of the decision which had led to its repeal. But the margin between revenues and expenditures

[1] *Wealth, Debt and Taxation*, 1913.

[2] *Report of the Controller*, 1914, p. 24.

is small, and a decided increase in the latter, or loss of some of the former, will necessitate raising the corporation tax rates, providing a new source of revenue, or resorting to the general property tax for state use. There is no elastic source of revenue and the danger of a shortage of revenue is imminent.

8. GROWTH OF EXPENDITURE

The rapid increase of expenditure which has absorbed the growing revenues as rapidly as they have been realized has not been abnormal. Total expenditures of cities increased 32 per cent in the years 1910 to 1912 as compared with 43 per cent in the years 1908-1910 before separation. The increase in 1914 over 1912 was nine per cent.[1] This does not indicate extravagance and any wasteful increase in expenditure on the part of local officials which could be attributed to separation would take place at the time of change. Municipal debts have increased rapidly, but the movement toward growth of bonded indebtedness started before separation was introduced. Separation would serve to check rather than encourage bond issues since it narrows the base on which the debt limits are estimated.

There has been no apparent effect on county expenditures.[2] Total expenditures rose 9 per cent in the year 1912-13. Ordinary expenditure rose 1.8 per cent.[3] Such increases are not abnormal. County debts, like those of municipalities, have risen rapidly, but, also as in the case of municipalities,

[1] *Financial Transactions*, 1911-1915; *Report of the Controller*, 1910.

[2] The state tax commission (*Report*, 1917, p. 12) believes that the local tax rate was kept unduly high at the time of separation. While this may have occurred in a few cases the fact that local expenditures as a whole have not increased abnormally does not seem to indicate that many of the localities took advantage of the change.

[3] *Financial Transactions*, 1913.

the movement did not arise out of separation. Whether extravagant or not such debts if affected at all by separation will be checked, for the entire burden is thrown on the property of individuals.

TABLE XXI [1]

INCREASE OF BONDED INDEBTEDNESS OF CITIES AND COUNTIES

Year	*Cities*	*Increase*	*Counties*	*Increase*
1911......	$65,573,033	..	$40,956,959	..
1912......	83,297,511	27%	52,846,981	32%
1913......	100,387,559	10	69,195,417	31
1914......	106,924,759	6	80,202,325	16
1915......	129,059,913	18	92,466,091	15

It is still, perhaps, too early to tell whether or not separation encourages extravagance in state expenditure, where waste is more likely to creep in under the new system. State expenditure has risen rapidly, but not more rapidly than that of counties and municipalities, the burden of which falls directly on the people; and apparently not more rapidly than state expenditure in other states where separation has not been adopted.

The state debt has increased greatly. In 1912, for the first time, it went above the maximum of $5,000,000 reached in 1867. Three years later (1915) it had increased more than five fold. Highways and public buildings are the principal causes of this debt,—and since at present the people apparently have more control over the legislature than the corporations it may very well be that the new system has encouraged such expenditures. The possibility of a return to the direct tax might retard them, although it probably has little weight. But granting that separation is the cause of these expenditures it still remains to be proved that they are unwise. Unless the benefits accruing are procured at

[1] *Financial Transactions*, 1913, 1915.

the cost of checking production—and corporations do not seem to be overburdened—they are probably advantageous.

9. ADMINISTRATIVE CHANGES

The effect of separation on the centralization of administration has been much the same here as elsewhere. Separation, while bringing intangible property and that tangible property most difficult to assess, *viz.*, the operative property of corporations, under state control, has tended to decentralize the administration of the local general property tax. The state board of equalization has not been deprived of its power of equalizing county assessments but in the absence of a state direct tax it has not seen fit to exercise it. Since the board never had the power of equalizing individual assessments this is not a serious loss. The inequalities between counties were never the most flagrant inequalities, and with the removal of the state tax they are of even less consequence. The county assessors have a larger field for their activities than local assessors in most states, and the position is of sufficient importance to get efficient officers. But as long as local election is adhered to a large percentage of untrained officials will hold the position and personal interest and local pressure will prevent unbiased and accurate assessments. Little equality can be hoped for under the present system. There has been some agitation for state-appointed assessors but the only action which has yet been taken is to permit the county boards of supervisors to appoint assistant assessors to aid the elected officials. As far as the general property tax is concerned there has been no gain, and some slight loss, in state control; but considering the fiscal system as a whole there is a marked advance in centralization.

10. OUTLOOK

This "revolutionary tax measure" has now been in force nearly six years, and none of the dangers prophesied has as yet developed. It has withstood the attacks made through the courts; the administration of the law, with the exceptions of the difficulties caused by the bond refunds and railroad reimbursements, and the complications resulting from the Panama-Pacific Exposition tax, has proved comparatively simple; revenues have been decidedly increased.

The ratio of assessed to true value has not risen as much as was hoped for by the proponents of the measure. With the removal of the Panama-Pacific Exposition tax and with the adjustment of local tax systems to the new system assessed valuations may rise more rapidly, until they approach true values, although with local election of assessors it seems unlikely. But if they do not, with the state tax removed inequalities will be of less importance. There is no longer friction between the counties concerning the ratio of assessed valuation to real value, but conflicts between the different towns of each county are undiminished.[1]

Separation has by no means brought complete equalization of the tax burdens; but it has succeeded in reaching a large amount of property which was formerly untaxed; and however unequal the present burdens, they are much more nearly uniform than under the former system.

Up to the present, the system has had good results. Separation was introduced in California to accomplish

[1] To cite an example of this, in Santa Clara County one town was given a "scientific valuation" for city purposes, with the result that the rate of assessment was raised fifteen to twenty-five per cent. The same valuation was then used for the county assessment, with the result that this town was forced to pay relatively a larger proportion of county taxes than the other towns of the county. Dissension among the towns ensued, but no satisfactory agreement could be reached.

one main end,—the equalization of the burden of taxes. Increased revenue also was hoped for, but this was secondary. The rapid rise in expenditure was met by the general property tax, although the taxpayers were becoming restless under the growing burden, largely owing to the increasing inequalities. Through the system of separation adopted it was hoped first to equalize assessments under the general property tax; second to shift part of the burden from real estate to corporate property, thus reaching much of the intangible property which was escaping. The division of corporate and other property between the state and the localities was largely a matter of expediency. In this way, it was believed, administration could be made most effective and the greatest equality be obtained. The argument was advanced that the state had the best right to tax corporate property and that real estate owed its allegiance primarily to the local government,[1] but this was put forward largely to support a division suggested by expediency. Had this been the serious purpose of separation more attention would have been paid to adapting the state's revenue to its needs, and less to making the burden on state taxed property exactly equal to that on locally taxed property. Although the pressure for funds has encouraged the frequent revision of the rates on corporations, keeping them abreast of the rates on other property, it has never been suggested that these rates might exceed those on locally taxed property. It is an equal burden, above all else, that has been desired, and a more equal burden has in fact been realized, although there is much to be desired.

Concerning the future of the system, there seems to be only one real problem, *viz.*, the adequacy of state revenues. The localities have proved conclusively that they can pro-

[1] *Report of Commission on Revenue and Taxation*, 1906, p. 79 *et seq.*

vide for themselves quite as readily with separation as with the old method. They have not lost their elastic system, and, though the base of the local tax has been narrowed, this has for the most part worked no hardship. The loss from the withdrawal of operative property has been more than offset in most cases by the gain through the removal of the state tax.

There seems to be little likelihood of extravagant expenditure in the future.[1] The pressure for revenues which is now being experienced should prove an effective check, both on the legislature and on the people, in any movement toward reckless appropriations, and there seems to be no chance of relieving such pressure without reimposing a direct state tax on either property or income, thus placing the burden directly on those controlling expenditure.

As for home rule in taxation, the agitation for such a measure has not met with such popularity that it need be seriously considered. Home rule—*i. e.*, local option in exempting property from taxation—has been advocated ever since the new system has been in operation. An amendment providing that each district, town, city and county (more than four thousand political subdivisions) should have the right to devise its own system of taxing and classifying property for purposes of taxation and exemption was put before the people of the state at a general election in 1912, but was defeated by a majority of over 50,000.[2] A similar amendment, voted on in 1914, met a similar fate.[3] This does not indicate a growing movement in favor of home rule.

[1] The state tax commission (*Report*, 1917, p. 11) believes that there is danger of state extravagance.

[2] In San Francisco a majority of 10,000 voted in favor of this amendment.

[3] *Report of State Board of Equalization*, 1914, p. 59.

Concerning decentralization of administration, the movement in that direction seems already to have spent its force. For the future everything points toward centralization. No positive steps have been taken, further than placing corporate property under state control, but there is increasing agitation both for a state tax commission with larger powers than the state board of equalization, and the state appointment of local assessors. Should such steps be taken, California would rank with the foremost states in the centralization of fiscal administration.

But the problem of adjusting state revenue to needs remains unsolved. There has been a large increase in revenues under the new system, even greater than was anticipated, but the increase in expenditures has easily kept pace with it, and while the rates on gross earnings of public utilities have twice been raised, the changes have been made in accordance with the growth of the local general property tax, and not in accordance with the growth of state expenditures.

Many new sources of revenue are being suggested, among them business licenses, particularly liquor, a stock transfer tax, stamp taxes, and an income tax. The liquor and income taxes are receiving special consideration. Any of these sources would relieve the immediate pressure for revenue, but none would introduce the desired element of elasticity, with the possible exception of the income tax, which might be introduced with a varying rate. Every effort is being made to avoid a return to the general property tax for state purposes. No action has yet been taken, but should any of the sources under consideration be adopted the danger of a deficit would be averted for some time at least.

But even if it should be found necessary to revert to a state *ad valorem* tax on general property, the benefits of

separation would not entirely disappear. It would again be to the interest of the counties to hold their rate of assessed valuation low; the burden on real estate would be again increased out of proportion to that on personalty; in short, the general property tax, with all of its attendant evils, would be reëstablished. But these evils would be less flagrant than formerly. For the state corporation taxes, which are reaching effectively property which before escaped, would be retained, and consequently the *ad valorem* tax on general property would be at most considerably lighter than under the old system.

CHAPTER X

The Movement toward Separation in the United States as a Whole

The states thus far considered are those which have carried separation so far that it has become a distinctive feature of their systems; [1] but separation exists in so many forms and in such varying degrees in the United States that a complete account would involve some description of the revenue systems of every state. A detailed examination is unnecessary for purposes of this study, but it is important to consider certain phases of the subject with reference to more of the states than have thus far been discussed.

To begin with, the question whether the tendency toward separation is increasing can be answered only by observing the trend in all of the states. The fact that of those states which have carried separation farthest, Connecticut, New York and Vermont have apparently abandoned it permanently in its complete form, and that California is maintaining it only with difficulty, would suggest that the move-

[1] Virginia, of which no special account has been given attained partial separation in 1915. This was made possible by the provision of the new constitution, adopted in 1902, which permits classification for taxation after 1912. Real estate and tangible personalty is subject to local taxation only, except for a 10-cent school tax. Intangible personalty except money, is subject to a state tax of 65 cents per $100. Counties may add as much as 35 cents per $100 to this tax. (*New York Tax Reform Association Bulletin*, no. 560, p. 8.) Since separation is only partial, and since it has been accomplished too recently for its effects to be apparent, it would not be worth while to give it special consideration.

ment has spent its force. Examination of the development in other states, however, indicates a growth of the movement. To draw a definite line between separate and other sources of revenue would be arbitrary and without significance. Instead, the proportion which the general property tax bears to other state revenues has been chosen as the better index of the growth of separation, since after all the movement is primarily an effort to abolish the general property tax. Taking the period from 1903 to 1913 (for which alone comparable figures are available) a decrease in the proportion of the state general property tax to total state revenue receipts is shown in twenty-nine states and an increase in seventeen. This does not, for the most part, mean an absolute decline in the general property tax receipts—only in six states does such an absolute decrease occur—but it does mean a growth, relative as well as absolute, in the receipts from other, and mainly from separate, sources.

TABLE XXII[1]

PERCENTAGE OF STATE REVENUE RECEIPTS OBTAINED FROM OTHER SOURCES THAN THE GENERAL PROPERTY TAX, 1903–1913

Percentage from Other Sources Than Property Tax	*Number of States* 1903	1913
1–20%	3	2
21–40	18	15
41–60	15	15
61–80	7	8
81–100	5	8

This is the result of the growth of special taxes which form such an important part of the systems of those states in which separation is most nearly complete. The reports of state officials indicate that this process will continue for some time unabated—even though in many cases there is no

[1] Estimated from data in *Wealth, Debt and Taxation*, 1913, vol. ii, pp. 36-39.

expectation of reducing, much less of abandoning, the state general property tax. There is an unmistakable growth in popularity of corporation, inheritance and income taxes. Corporation taxes are already employed in one form or another in practically every state; inheritance taxes are now used in all but nine states; and the income tax, though actually in force in only seven states (and unimportant in most of these), is much advocated. There is also a movement, owing to the growing need of special taxes, to abolish all "equal and uniform" clauses from the constitutions. These clauses, by demanding that all property be taxed at the same rate and in the same way, have interfered with, and in most cases prevented altogether, classification for taxation. Nearly half of the states are still thus hampered, although constitutions are being amended so as to abolish such restrictions almost yearly.[1] All of these changes make separation more possible and an increase in separation almost invariably follows.

The second question, which has so far only been partially answered is: What are the conditions which encourage separation? Speaking broadly, the general property tax forms the largest proportion of state revenues in the states west and south, and a much smaller proportion in those east and north. Yet there are many exceptions. California, for instance, has complete separation, and Maine obtains half, and New Hampshire more than half of state revenues from the general property tax. Further, the two states depending most on the property tax (Arizona, where it forms 81 per cent, and Michigan, where it forms 85 per cent of state revenues) would seem to have few character-

[1] This material has been derived mainly from the Census Report, *Wealth, Debt and Taxation*, 1913. It has been checked and brought up to date (March, 1917), by *Conference Proceedings; Bulletins of the New York Tax Reform Association;* year books and state tax reports.

istics in common.[1] However, eight of the nine states with a large degree of separation are grouped together, and four states adjoining these (Massachusetts, Rhode Island, Virginia and Ohio), depend on the property tax for less than one-third of state revenues. It may be said, in spite of notable exceptions, that separation has followed industrial development.

There is also a very immediate relation between separation and growing expenditure. Although expenditure in twenty-six of the states did not increase as much as one hundred per cent in the years 1902-1912, Delaware alone of the states having separation is included in this group. The reason is obvious. On the one hand, industrial development and growing population call for extension of governmental activities, and consequently for increased revenues; on the other hand, such development puts an increasing proportion of wealth in forms difficult to reach by the general property tax. Under this double strain the financial system breaks, special taxes are introduced, the general property tax declines and separation grows. Some states with large corporate wealth, *e. g.*, Michigan, have made heroic efforts to retain the general property tax. Others, where state expenditures are comparatively small, have kept the general property tax small without corporation taxes. North Dakota, for instance, with a large income from the rent and sale of public lands, uses the general property tax for less than forty per cent of state revenues. But in the main the states with the highest industrial development have been forced to adopt special taxes while the agricultural states have neither had the incentive to do so, nor, their wealth being largely in real estate, have they had the opportunity to

[1] The apparent explanation in this case is that both are important mining states and have developed an effective system of mining taxation under the general property tax.

profit by it. Kentucky, after carefully considering the replacing of the general property tax with special taxes, eliminated the proposal because of the small amount of corporate wealth in the state.[1]

A comparison of assessed values in states with and without separation shows little difference. The highest as well as the lowest ratios of assessment appear in states without separation. Separation appears, however, to have had some small influence in raising the ratios of assessment in cities.

There is a growing and widely commended tendency in the United States to centralize administration in financial matters. The increase in state tax commissions and commissioners, and the widening powers of state boards of equalization and other state financial boards and officials, are all indications of this. The movement is widespread, appearing in those states depending only slightly on the general property tax as well as in those using it as the main source. It has arisen, much as separation has arisen, to cure the evils of the general property tax—although it is of equal importance applied to any locally administered tax where uniformity in the different taxing jurisdictions is for any reason desirable.

A study of this tendency leads to the conclusion that it is a distinct movement, related to separation only in that both are the outcome of the search for greater efficiency. Very few states are without some central financial board or official, having supervision over local administration, at least to the extent of equalizing local assessments for state purposes; but in spite of this little effective control has been developed. General supervisory powers are not enough. Frequently the officials are without the power or the equipment to obtain the necessary information. More often they

[1] *Report of the Special Tax Commission of Kentucky*, 1912-1914, pp. 103-104.

are hampered in the use of the information they have obtained, either because of limited powers of changing equalized values or because of lack of control over the local officials. It is generally conceded that effective control over local officials can be obtained only through the central powers of appointment and removal. These powers have rarely been granted. Only eight states thus far have given to state officials any power of appointment or removal of local officials, and the power granted by these states is very limited.[1] Only in one state (North Carolina) are the county assessors themselves appointed by state officials. In other states the officials appointed are not those really controlling administration. Where the power of removal is granted it is generally limited to cases of wilful negligence, which is in practice impossible to prove.

Central control of local financial administration is only nominal as yet, but there is nothing to suggest that separation is seriously interfering with the movement. Of the eight states attempting to control local officials, one, New Jersey, has essentially complete separation, and three obtain more than sixty per cent of state revenues from separate sources. Both centralization and separation aim to abolish the evils of unequal assessments. In so far as separation abolishes these evils—which it does to a limited extent—the need of centralization is lessened. But inasmuch as it cannot in any large measure equalize assessments, the need of centralization remains, and will doubtless be met. Separation does not prevent it, though it does to some extent discourage it.

[1] See *supra*, p. 178 n.

CHAPTER XI

Conclusions

The study of the gradual growth of the separation of sources of state and local revenues in the United States during the past fifty years leads to the conclusion that this growth has been primarily an incidental result of the effort to supplement the general property tax. When poor administration has made this system inadequate, special taxes have been placed on definite classes of property—taxes which the state can administer successfully. Separation has been only secondarily a conscious "reform" offered as a definite remedy for unequal assessments and other administrative ills. Of still less importance has been the argument that that government whose people are the cause of the creation of a value has the best right to tax it.

Although separation was definitely advocated even before 1880, the movement during these early years was small and but little discussed, no state accepting it as a definite goal toward which to strive. Agitation has increased in the last twenty years, but interest after all has centered around individual taxes rather than around tax systems. Every conceivable form of corporation tax has been experimented with, and the possibilities of inheritance taxation and of special taxes on intangibles have been rapidly developed. The result has been steady progress toward separation in many states and the advantages of separation have often been advanced in these as an additional reason for change. But California is the only state achieving separation without a preceding period of slow

development in that direction. In no other state where the introduction of separation involved a radical change in the seriously considered in several cases.[1]
financial system has it been adopted, though it has been

The ends sought (conscious and unconscious) by the movement toward separation have been larger revenues and better administration. These have to some extent been attained.

A further result—considered by Professor Plehn to be the most important—which those advocating separation as in itself a desirable step have hoped to attain, is an equitable division of the yield of taxes between state and local authorities. By equitable, as already explained, is meant a division which gives to each jurisdiction the revenues derived from those values which have been created by the people living within that jurisdiction.[2] Whether or not this has been realized is difficult to ascertain. Unquestionably the value of some corporations, such as gas companies, is created by local conditions; that of others, such as munitions factories at the present time, is in large part of international origin. On the other hand much of the value of real estate is derived from sources outside of the immediate locality. But in spite of these exceptions a division which gives real estate to the localities and corporate property to the state corresponds in some measure with the division of revenues desired. If this is advantageous, and in some cases the advantage is quite apparent,[3] then separation has partially achieved a desirable end which can be achieved in no other way. This particular gain would be lost if an income tax were made the principal source of state revenues, as is often

[1] *E. g.*, Louisiana, Iowa, Missouri and Kentucky.

[2] *Supra*, p. 16.

[3] See discussion of railroad taxation in California, *supra*, p. 136.

advocated, for the ultimate source of a general income tax and of a general property tax must be the same. But this gain from the division of sources is not a vital one. It will lose its significance more and more as the individual communities and states become increasingly interdependent.

Separation is only one of many ways to improve administration and increase revenues. Yet it has been mainly to accomplish these ends that it has been introduced. The administrative reform hoped for has been the equalization of assessments. The influence of separation in this respect cannot extend to the inequalities between the smaller districts and between properties of different kinds, and of the same kind, within each district,—which are very serious; but it has been expected that the inequalities between counties (or other divisions which may be used as the local units of assessment) would disappear with the removal of the state tax which encouraged underassessment.

To some extent in California and New York, particularly in the latter state, ratios of assessed to real value have been raised in the larger cities,—notably in New York city where the ratio is approximately one hundred per cent. Separation has encouraged this in a negative way by removing the state tax. In New York city, at least, such an increase would not have been permitted had it not been confidently expected that the state tax would not be again imposed. But the real reason for the high ratios is that they have been necessitated by the tax and debt limits on the municipalities of these states. The cities have been forced to raise their assessments to this extent in order to obtain the necessary money to carry on their activities. In rural districts where expenditures are small there has been no indication of an effort to increase the assessment ratio. In California the latest estimate (1916) gives the average assessment ratio as 43 per cent. As earlier estimates were at 45 per

cent there has apparently been no gain here. In New York, outside of a few of the larger cities, the average ratio is about seventy per cent, as it was before separation. In Connecticut ratios of assessment were first increased when the state direct tax was reimposed in 1910. In New Jersey where an actual increase has been realized it can be accounted for by better methods of administration. Separation cannot be credited with any important gains in this respect.

Certain actual gains have, however, been realized. First, in the absence of the state tax the inequalities between counties are of less consequence than before; second, with the introduction of special taxes many of the classes of property difficult to assess under the general property tax are reached in other ways, and the general property tax itself has declined, relatively, in importance, so that its inequalities are less serious than they would otherwise have been.

But the general property tax, even when given up entirely by the state, remains an exceedingly important factor, and its effective administration is of concern to all. Equalization of assessment is not attained automatically through separation. On the contrary separation is apt to deaden state interest and in consequence to encourage the withdrawal of state control, and in that way to remove the only available means of attaining uniformity.

Separation has been opposed on this ground,—that it leaves the local divisions unsupervised in administering their revenue systems; in other words, that it is a counter-current toward decentralization in the far greater movement of fiscal development in the direction of centralization of financial control.[1] The advocates of separation, however, claim[2]

[1] *Annals of the American Academy of Political and Social Science*, 1915, vol. lviii, p. 134 *et seq.*

[2] Seligman, *op. cit.*, p. 367.

that separation does not lead to decentralization. This study has shown that separation, by removing the immediate interest of the state in local affairs, has in some cases retarded centralization. Vermont definitely gave up the function of equalizing local assessments in 1884, thus taking a step backward, but more recently (1910) enlargement of the powers of the commissioner of taxes has increased control of local administration. In California also the state board of equalization, without giving up the power of equalization ceased to exercise it after the introduction of separation. Efforts are now being made, however, to extend state supervision. Separation in Pennsylvania has not been the cause of any definite change in administrative control, but the fact that locally administered state taxes are more carefully supervised than locally administered local taxes suggests that separation has checked centralization in some degree. New York and Connecticut have not, and never have had, effective control of the general property tax, but it is doubtful whether without separation they would have attained it. Other states without separation have not done so. Separation, negatively, encourages decentralization in so far as the general property tax is concerned; but it cannot therefore be regarded as a positive step toward decentralization. On the contrary it would seem to be a stage in the movement toward centralization. In some cases, as has been pointed out, it has removed some small degree of state control from local administration, and in other cases it has retarded the growth of such control; but this has not occurred in all cases, and where it has occurred it applies only to the general property tax. Furthermore, such state control as has existed has been scarcely more than nominal. The gain in centralization through putting certain classes of property difficult of local assessment directly into the hands of state officials has more than offset any loss in

giving up state supervision of the general property tax. As one by one the different classes of property are removed from the category of general property, and as the various special taxes begin to outweigh the old general property tax in importance, it will become only one of many of the objects of state administration. Of course, the general property tax is still far from becoming unimportant, even though relegated to the localities. Rather, the rapidly growing needs of cities are making it a matter of more vital concern than ever before, and as it grows in importance the need of central administration becomes more apparent.

Real central control of local financial administration has not as yet been attained anywhere in the United States. Most sources of local revenues, other than the general property tax, have always been locally controlled. As for central control of the general property tax, this can be attained only through adequate central powers of appointment and removal of local officials. These have not been granted in any state, but they are quite compatible with separation, and will probably appear in those states where separation exists as soon as in others, since separation has not in any measurable degree done away with the need of them. In so far as centralization of the administration of local finances has been attained at all in this country it has been attained as readily with separation as without. West Virginia has some central supervision of the administration of local finances although local officials are elective. New Jersey has as effective central supervision as any other state. The state board of equalization has wide powers, even including the removal of local assessors—though as already pointed out this last power is little more than nominal; and county boards of equalization are appointed by state officials.

The administration of state finances has been distinctly

centralized by separation. The locally administered general property tax has been supplanted by new special taxes directly under state administration.

The large increase in revenues expected from separation has been cited as both a danger and an advantage. The danger was felt to be in the creation of large sources, the burden of which the people in general—who are ultimately responsible for all expenditures—would not feel.

This fear that separation would encourage unnecessary and extravagant state and local expenditures is apparently unfounded. Separation would provide an opportunity for extravagance in local expenditure only at first when a decided decrease in the demands on the general property tax occurs; for only at such a time, probably, would unnecessary local expenditures, the burden of which would fall directly on the people, pass unchallenged. In most cases separation has been introduced so gradually that no large decrease has occurred; and in the few cases where there has been a sudden change there has been no indication that local officials have taken advantage of it. Expenditures have risen steadily and rapidly with the extension of governmental activities, but such increase is scarcely more characteristic of states with separation than of states without.

It is in state expenditures, however, rather than local, that such extravagance has been most confidently anticipated. The assumption is that the removal of the state direct tax will remove the one restraining force; that the people, no longer paying directly for expenditures incurred, will freely authorize appropriations for unnecessary and even extravagant purposes. This may occur in some small measure but there are a number of influences to check it. In the first place any great extension of expenditures leads almost inevitably to a return to the general property tax. Secondly, in most states the people have no such direct con-

trol of expenditures as this implies. Economy or extravagance is apparently due to responsible or irresponsible budget procedure rather than to the system of taxation.[1] Flagrant misuses of the general property tax revenue would doubtless in time be realized and stopped by the people; but past experience seems to indicate that the corporations which bear the weight of the burden under most systems of separation are quite as sensitive to taxes as the people at large, and quite as capable of preventing excessive levies. And more than this, even though the rate on corporations is frequently changed, it is not adjusted to annual needs, and only occasionally has it proved ample enough to allow any excessive expenditures. That these influences have outweighed those encouraging extravagance is shown by the growth in expenditures in those states experimenting with separation. Expenditures have grown more rapidly, on the whole, in these states than in most others, but this is due, as already explained, to the fact that it has been the more advanced states which have introduced separation and in these expenditures might be expected to increase more rapidly than in other states irrespective of the influence of separation. Indeed the rapid rise in expenditure has begun before separation has been attained. Further, in those states which have abandoned separation (*viz.*, New York, Connecticut and Vermont), the rise in expenditure has been more rapid after returning to the direct tax than before. The system of separation, which is adopted to relieve the pressure for revenues, at first easily satisfies all needs; but in the end its comparative inelasticity hampers the rapid growth which it at first encouraged, and it is discarded as incapable of supplying the increasing demands.

[1] *Cf. Bulletins of the New York Bureau of Municipal Research*, nos. 62, 70, 73, 80.

This inelasticity has thus far proved to be the insurmountable obstacle which has prevented the continuation of separation. No system of separation has included a variable state tax, and only under very favorable circumstances have the states been able to meet their needs without one. Delaware and West Virginia, with comparatively few state activities, and light expenditures, have not suffered; neither has New Jersey with her large returns from incorporation fees; nor Pennsylvania with her well-developed corporation taxes. But Connecticut, New York and Vermont have one by one returned to the state general property tax, and California, in her efforts to avoid it, is continually searching for new sources of revenue. Apparently the states cannot perform their proper functions without a variable tax. Central governments in Europe have operated successfully without such a tax, but central governments in Europe have been for the most part thrifty and far-seeing; their expenditures have increased less rapidly and less spasmodically; their administration has been more responsible and more efficient. In the United States administration has not yet attained the efficiency and responsibility which would make such a system feasible. A variable tax is at present essential. Such a tax might be obtained by making the rates of corporation taxes variable, although this has never been advocated. Or the income tax which is meeting with such favor might be introduced at a variable rate. With the introduction of an income tax for state purposes complete separation of source disappears and is replaced by what Professor Plehn has designated as "true separation." This system would destroy none of the advantages of separation of source with the exception of the rather doubtful advantage of the allocation of revenues according to the origin of the values from which such revenues are derived. And this system would supply, as separation has not always

done, sufficient revenue. For even though the rates were fixed, they could be changed enough from time to time to keep a close correspondence between revenues and expenditures.

To sum up: Separation of source has been introduced primarily to improve financial administration and increase revenues. It has improved administration of state finances to the extent that it has put important taxes in the hands of state officials, but local administration is little better than before. This, too, must be put under central control to be made efficient—and can be, for separation of source does not necessitate separation of administration. There is nothing inherent in separation of source which will either achieve or prevent efficient local administration.

Revenues are increased with the creation of the new taxes which are generally introduced with separation. Such increase of revenues from taxes not paid directly by all property owners has not increased extravagant expenditure appreciably, principally for the reason that the control of the people at large is not sufficiently direct to be effective even when they feel the tax. Popular control of expenditures depends upon the form of budget procedure. The increase of revenues at first brings relief to an overstrained system, but the new system is not sufficiently elastic to expand rapidly with growing needs. Consequently complete separation has been generally abandoned.

There are no advantages to be derived from complete separation of sources which cannot be derived in other ways, and there is little likelihood that it will become a permanent feature of any state's system; but as a transitional stage in the movement from the general property tax widely applied to classification for taxation it will doubtless play an important part. In the states where it has been introduced thus far it has been a mark of progress.

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